AIR NEW ZEALAND

14 September 2011

International Freight Transport Services Inquiry
New Zealand Productivity Commission
141 The Terrace
Wellington

freightinquiry@productivity.govt.nz

Dear Sirs

International Freight Transport Services

We refer to the July 2011 Issues paper on the above industry and wish to offer our submission on selected matters pertinent to the air freight aspects of the industry.

Air New Zealand welcomes this review, recognising as it does the importance to New Zealand of freight services and in the modern commercial world of "just in time" and rapid delivery expectations, the air freight industry in particular. New Zealand's unusually high reliance on fresh food and other agricultural / horticultural products makes a sustainable, efficient air freight industry a high national priority.

Air New Zealand

Air New Zealand, as the national carrier, has the largest presence in New Zealand of any international air freight carrier and operates on more direct routes outbound from New Zealand than any other airline.

Air freight is an important part of Air New Zealand's business earning revenues of $374m (FY09), $255m (FY10) and $278m (FY11) in the last 3 years – the trend reflecting the global financial crisis.

A description of the air freight industry and Air New Zealand's role in it is set out in the Appendix to this submission.

Introduction

The following observation by the Commission sums up the difficulties of the airline and airfreight industries as they try to transition from a highly regulated commercial environment to a modern world of competition:

> "*The challenge, from a regulatory perspective is to implement rules and mechanisms that offer the best balance between competition and coordination.*" (*Issues Paper - Page 18*)

Air New Zealand Limited, 185 Fanshawe Street, Private Bag 92007, Auckland 1142, New Zealand
Telephone 64-9-336 2914 Facsimile 64-9-336 2667

In 1944, the internationally supported Chicago Convention established a highly prescriptive regime for the airline / air freight industry to accommodate concerns of national sovereignty and establish, in an international environment, a network industry. Over the last approximately 30 years that regulated approach has given way to the demands for competition – but not uniformly. This trend is reflected in the shipping industry as is commented on at pages 36 and 37 of the Issues Paper.

The international airline / airfreight industries operate in a tension between sovereign states which continue to apply prescriptive regulation in furtherance of government to government negotiated air traffic rights (Air Services Agreements "**ASAs**") and those that have abandoned that approach in favour of efficiencies being driven by market competition. New Zealand has elected the latter approach and been an international leader in pressing for the more liberal, pro-competition style of ASAs known as "Open Skies" agreements with other governments, but remains a party to many ASAs still in force under the highly regulated approach.

The "Collusive behaviour" (*Issues Paper - page 45*) prosecution referred to by the Commission is in large part a product of attempting to impose New Zealand's competition approach on conduct in other sovereign states which abide by the terms and regulatory requirements of their ASAs with New Zealand. The airlines are caught between the proverbial "rock and a hard place" in trying to comply with both.

This review by the Commission is timely. Business in New Zealand (and elsewhere) complains increasingly of the burden of more regulation driving inefficiency when we need to be looking for simplification and efficiency. The reality though is that New Zealand, while looking to its own laws, must take account of its international obligations and not try to move at a pace or in a direction that is internationally inconsistent. To do so puts New Zealand businesses at risk in New Zealand and in other countries by imposing even more, multiple and often conflicting obligations.

Submission Structure

We have confined our submission to the key elements affecting our own business as that is where we can add the best value to the Commission's review. Accordingly we will comment briefly on airports then focus on air freight.

Airports

Q.27 Are Auckland, Christchurch and Wellington airports subject to competitive pressure for the air-freight related services they provide? Do they exert market power to the detriment of New Zealand exporters and importers?

Airports are unusual in that they are most often monopolies in their own geographic market (two or more closely located airports of similar scale is a very rare situation internationally) but to a limited extent, compete with other airports for passenger and particularly cargo traffic. Airports try to attract airlines and their passengers with introductory special prices and market promotion incentives, but these are usually of

short duration and suffer from the wider competition between destinations. If passengers want to go directly to Queenstown that is where an airline will fly to regardless of how cheap landing fees might be at Hamilton. Cargo is less sensitive to direct or indirect routes and airports can compete from geographically different areas according to the ultimate destination of the cargo and the land based distribution systems available.

At a practical level in New Zealand, such airport competition as does exist is only between Auckland and Christchurch for most freight. The runway at Wellington Airport is too small to land "wide body" aircraft that serve markets other than trans Tasman and Pacific Islands. Most air freight to and from New Zealand is carried in the belly-hold of wide body passenger aircraft, most of which only operate to Auckland. The specialist freighters are also wide-body aircraft limited to Auckland or Christchurch.

Add the New Zealand geography and the cost of shipping between islands becomes obvious. If freight is destined for the South Island, onward trucking/rail from Christchurch after international arrival into Christchurch will be the most efficient. Similarly Auckland will be the natural destination for North Island bound goods, although transfer onto domestic aircraft or trucking/rail to South island is also commonplace from Auckland, drawing on the airport hub attraction of Auckland driving the much higher number of flights there.

From an airline and freight forwarder perspective, the airports compete looking for new airline customers or specialist air freight operators. Between the Auckland and Christchurch airports, Auckland has a substantial advantage in attracting freight forwarders based on the number of flights already available to shippers and the much larger volumes of freight destined to or exported from the North Island.

Undoubtedly Auckland Airport exercises its market power in pricing all its services, to the extent of being able to take revenue from incumbent customers specifically for the purpose of marketing itself to prospective new customers. While all businesses arguably "market" using revenue from existing customers, New Zealand airports do so with impunity and still manage excessive returns on their investments and /or re-valued assets.

Uniquely in the global airports industry, New Zealand expressly legislates to allow an airport (already a natural monopoly) to "set such charges as it from time to time thinks fit" (**Section 4B Airport Authorities Act 1966**").

This regime makes New Zealand airports among the most profitable in the world based on charges out of proportion to true input costs. This added airport cost at the end of very expensive long-haul flights makes air freight costs into and out of New Zealand some of the most costly (by weight) anywhere.

Q.28 Do current ownership and governance arrangements of New Zealand's international freight airports have any significant positive or negative effects on their long-term efficient configuration and operation, with respect to the supply of freight services?

We do not consider that ownership *per se* of New Zealand's international freight airports has a significant effect. Both private and government owners are profit incentivised to ensure efficient configuration and operation. The governance / regulatory environment referred to in answer to Q.27 however does not incentivise the *most* efficient operations. With a monopoly rate of return on investment guaranteed by legislation, there is an inherent incentive to over invest in infrastructure and insufficient incentive to secure the most efficient operating cost. The natural tendency is to improve profits by the simpler expedient of raising prices.

Q.29 The objective of a port company under the Port Companies Act is to 'operate as a successful business'. Should airport companies owned by local authorities have the same single objective rather than the multiple objectives specified in the Local Government Act?

A similar provision exists in s.4 (3) of the Airport Authorities Act which requires airports operated or managed by an "airport authority" to be "operated or managed as a commercial undertaking". Regrettably this requirement has not been interpreted by the Court as preventing such airports from charging monopoly prices, notwithstanding that few "commercial undertakings" are monopolies. (*Ref: Air New Zealand Ltd & Others v Wellington International Airport Ltd CIV 2007 485 1756 Judgement of Wild J, 24 April 2008, see discussion paras 21 - 45.*)

Airports are rightly considered "strategic assets" whether government or privately owned. While it is deemed for government owned airports, the self promotion by Auckland Airport in particular also underlines the strategic nature of airports with claims of vast "contributions" by its gateway, to the wider New Zealand economy. (*Ref: "Auckland Airport Future Economic Impact Assessment – An Assessment of the future contribution by Auckland Airport to the Auckland Region and New Zealand Economies" – Prepared for Auckland Airport - Market Economics – September 2010*)

Although of limited relevance in air freight, Queenstown Airport is a classic case where in full public (local authority) ownership its strategies could be developed with the wider community interests in travel and tourism industries being subordinated to the direct profit motives now required by its new commercial investor, Auckland Airport.

The best answer is a balance. On one hand airports need to earn profits sufficient to make the airport commercially sustainable and able to grow with sufficient investment to meet the changing needs of air freight. On the other hand are the needs of New Zealand exporters and importers to be able to secure air freight services at levels supportable by their own businesses. Air New Zealand has often encountered situations where New Zealand exporters faced serious losses through world markets, weather conditions and the like, such that exporting would not have been viable but for a temporary air freight rates reduction. A wider perspective from airports, whether government or privately owned would be welcome. That perspective will not occur under the current legislative regime.

Q.30 What levels of investment have Auckland and Christchurch airports undertaken in international freight, and are they consistent with accessible and efficient services for New Zealand exporters and importers?

Airport investment is generally focussed on the needs of passengers in terms of runways and terminals. This is why in many countries air freight is "relegated" to older airports and facilities uneconomic for passenger traffic. The returns for airports from passengers outweigh those available from freight except in well developed modern and efficient facilities. In New Zealand, air freight benefits from the essential infrastructure development of airports but most freight specific facilities are developed by Air New Zealand and freight forwarding businesses. Over recent years the dramatic escalation in airport costs has progressively driven more freight facilities to less efficient but less expensive "off airport" locations. This has also applied to other services such as catering and waste disposal which have re-located "off airport".

Q.31 Should the future size and shape of New Zealand air freight services be left to market forces and individual airport owners, or do lumpiness and interdependence (including with investments in connection parts of the overall supply chain) call for a more deliberately coordinated approach?

In the context of airport investment, air freight services impose modest burdens on airports. Most of the infrastructure cost, although substantial, is spread over a long asset life and is primarily directed at and recovered through passenger traffic. Freight services simply use the same runway and "apron" facilities. The aircraft ground handling is provided by airlines in conjunction with handling passenger aircraft or by specialist ground handling businesses. The supporting facilities such as warehouses, cold storage etc are all funded by the airline operators either through direct investment or are leased from the airports. The shorter term "lumpiness" of investment requirements and seasonal and other shifts in market demand are borne by airlines providing the air lift capacity to and from the airport.

The constraint on air freight services (to the extent there is one) is the ability of an airport owner to dictate to airlines and freight forwarders the location, cost and nature of air freight facilities based at airports. This goes yet again to the Airport Authorities Act which not only allows excessive pricing but can permit in quite wide circumstances, an airport company to take back land and acquire tenants' buildings and improvements, often without compensation. These circumstances are not conducive to investment by airlines in air freight facilities.

Q.32 What are the most appropriate measures of airport performance in international air freight? Can you assist the Commission by providing data that compares New Zealand airports against others?

For airlines and their freight- forwarder customers, the goal is minimum delivery time from aircraft to hand-over (to the freight forwarder) at the lowest possible cost. Airlines can mange much of the delivery time element, but are always subject to airport delays. These can include circling to await a landing slot and waiting for an

airport "gate" to be made available for loading and unloading or longer term issues such as the distance from aircraft to cargo handling warehouses.

The costs include the controllable costs driven by the ground handlers' efficiency. These include staff costs and numbers, investment in specialist aircraft handling equipment and general overheads. The uncontrollable costs are the landing charges and other fees imposed by airports. As discussed above, New Zealand legislation allows an airport to set these charges "as it sees fit".

Q.33 Are there opportunities to introduce or increase competition in the provision of air freight-related services at airports? Would such competition lead to better outcomes?

With 23 airlines providing air freight services to the two key New Zealand airports there is more than adequate airline capacity and cargo shipments are strongly competed for. There are two ground handling businesses operating at New Zealand airports and no material barriers to competitor entry. Numerous freight forwarders support the air freight market from facilities on and off airport land. The only area where there is complete absence of competition is the airports themselves within their respective geographic markets.

It is clearly nonsensical to build competing airports (i.e. in close geographic proximity) in New Zealand but there is a very long overdue and increasingly urgent need to regulate for efficient airport pricing. This would be a very low cost opportunity to significantly affect the total cost of importing and exporting goods.

Q.34 Is the existing and planned Commerce Commission regulation of airports sufficient to restrain monopoly pricing and induce an efficient level of investment? If not what should change?

There is no "existing" Commerce Commission regulation of airports. The Commerce Commissions powers are limited to making a recommendation to the Minister. The Commerce Commission Inquiry in 2002 made a recommendation to impose certain pricing controls but it was rejected.

The planned regulation of monopoly pricing under the Commerce Amendment Act provisions is for now, targeted only at "information disclosure" – at best a weak attempt to embarrass airports into moderating their pricing aspirations. To date, even this is hamstrung in complex litigation and although technically in force, the information disclosure regime is having no apparent effect. Wellington Airport for example recently notified its claim for an approximate 70% increase in annual aeronautical revenues.

Once the information disclosure regime fails to affect airports' behaviours, as it will, it will be a matter of years before an effective regime can be implemented under the progressive steps required by the Commerce Amendment Act,

The many millions of dollars being expended by the Commerce Commission in the current "collusive behaviour" proceedings could have been (and still could be) better

applied to addressing the monopolistic behaviour of airports. The substantial resources applied by Government and the Commerce Commission to the Commerce Amendment Act – and the Commerce Commission's ongoing legal defence of the information disclosure regime, could be better applied to adoption of a simpler and more effective regime that would deliver tangible benefits to consumers much sooner than the 7 or 8 years they will now have to wait.

International Air freight

Q.35 To what extent is the international air freight industry competitive?

As a generalisation we regard the "air freight industry" as very competitive, but that needs to be considered more carefully in the context of the many markets that comprise the "air freight industry". At a functional level these markets include airline capacity, ground handling services, airports (see above) and freight forwarders. To those should be added the integrators and consolidators (referred to in Appendix) which span more than one of these markets. We will focus on airline (cargo) capacity but note that many issues are common to airline passenger and air freight industries.

Competitiveness also needs to be considered in the geographic context of not only "sectors" between two airports but directionally (an origin airport to a destination airport considered in each direction). As is often noted, cargo only travels one-way, usually resulting in the same capacity each way on a sector but an imbalance between inbound and outbound demand for capacity.

The complexity of the air freight business also requires it to consider the nature of goods shipped. Fresh produce and flowers are seasonal, electronic goods will have Christmas supply peaks etc. Consequently the demand for air lift capacity on any sector, in each direction is very volatile.

Conversely the supply of air lift capacity is by comparison, stable. Airline schedules for passengers cannot easily change on short notice to increase or reduce capacity on a particular sector and most cargo capacity to and from New Zealand is dictated by availability on passenger aircraft. Despite that, at the margins (say the last 5-10% of capacity), it is quite volatile. The cargo capacity by weight on any flight is finely dictated by aircraft take-off weight and weather. Higher or lower than expected passenger loads or anticipated headwinds or tailwinds in flight increase/decrease the weight and fuel requirements up to the last hour before a flight requiring adjustment down or up of the cargo to be carried.

Cargo revenue is typically treated as a contribution to the total cost of operating a flight to the extent the revenue per kilo exceeds the cost of fuel to carry that kilo. Consequently every additional kilo of cargo is considered valuable as it contributes directly to profit. All these factors mean that airlines compete strongly for cargo generally but especially for the valuable "last minute" or incremental shipments.

In the New Zealand inbound and outbound air freight markets, there is for most of the year, excess cargo capacity available. This is driven by the large number (23) of airlines operating here on a scheduled basis, including 2 specialist cargo freighters –

all disproportionate to the country's export needs. This reflects the excessive passenger capacity on "Fifth Freedom" carriers which fly trans Tasman as an add-on to services from third countries to Australia and can do so at marginal cost allowing them to operate with low fares and passenger numbers. This capacity flows through to cargo. Such aircraft are "wide body" with substantial cargo capacity; enhanced by low passenger numbers leaving more of the payload available for cargo.

Over the past 15 years or so, airlines operating cargo services on the Tasman have also come under competitive pressure from shipping services as sea ports in New Zealand and Australia have increased their own efficiency, especially delivery times. This has reduced the advantage of airlines in respect of time sensitive shipments which can now be delivered by sea in 3-4 days. Sea freight is now regarded by air freight operators as a significant competitive pressure.

Q.36 Are there specific air freight routes to or from New Zealand with low levels of competition? Is there evidence of overpricing or poor service levels on these routes?

Air New Zealand operates on a very small number of routes to / from Pacific islands on which it is either the only airline or one of two. Despite the low levels or absence of existing competition on those routes, freight charges are similar to those on equivalent but competed routes. The nature of imports and exports to those Pacific Islands is such that freight charges have to be kept at levels which particularly the exporters from those islands can afford to pay and still have their goods delivered to their ultimate markets at competitive prices in those markets. This can only be achieved commercially by airlines regarding freight revenue from those locations as incremental revenue which at times may not recover the cost of the fuel required by the freight.

Q.37 How do bilateral air services agreements affect the accessibility and efficiency of air freight services available to New Zealand exporters and importers?

Bilateral Air Services Agreements (ASAs) are by their nature, restrictions on access to markets for both passenger and air freight services. This reflects the ability of sovereign states to determine access to their own airspace under the Chicago Convention. The extent of restriction varies according to the government-negotiated outcome and ranges from material restrictions to few restrictions ("open skies").

To the extent cargo is a by product of passenger services there are a few relevant restrictions. For example the NZ / Hong Kong ASA and the NZ / China ASA each impose limits on passenger services which flow through to cargo, but each of those markets has excess air freight capacity most of the year.

Although some ASAs impose some restrictions, we are not aware of any which create a shortage of supply of air freight in any particular market. While there may be occasional pressures on supply or markets not served directly (almost any international airport can be accessed by indirect services) which an exporter or

importer may desire, the restriction does not arise from the ASA as far as cargo is concerned.

Q.38 What explanations exist for the different treatment of the international air freight in the Civil Aviation Act compared with the normal competition requirements of the Commerce Act? Do the objectives of the current regulatory treatment continue to be justified?

As noted above, ASAs are by their nature restrictive agreements which breach the basic principles of open competition. They typically create capacity restrictions and strictly control ownership of airlines. They are however government agreements between sovereign states. They are also each unique, creating an international "patchwork" of regimes to be complied with by airlines operating to, from, over and through multiple sovereign areas in the course of international network operations for passengers and cargo.

As competition laws have evolved, each sovereign state has developed its own regime – or in some cases elected not to have a competition law – creating another conflicting international "patchwork".

Competition laws do not readily align with ASAs as their primary focus is compliance in the context of national commerce with regard to international dimensions limited to the effects on a national (domestic) market. Competition law seeks to create a "level playing field" for competitors – a circumstance which for international airlines has been referred to as a "distant dream".

ASAs evolved as a means for governments and their owned or designated airlines to create an international transport network which for nearly 70 years has been a major positive influence on global economic growth and trade – although ironically the airline industry collectively has itself lost value through most of that period particularly post de-regulation. The negotiation of these agreements has taken into consideration a wide range of governments' trade and diplomatic priorities. If such "anti-competitive" agreements were subject to the strictures of competition law, an international aviation network would still be in its infancy, or not exist.

Notwithstanding the special status of ASAs, airlines themselves are required to comply with the competition laws of each state in which they operate. To manage the limitations imposed on multi-national ownership of airlines, a range of joint venture agreements have evolved such as code shares and a wide variety of alliances. These are typically required to pass competition hurdles in terms of their effect on competition and net public benefits to each affected state. A "global" net public benefit is insufficient – each state must be satisfied. Such regulatory processes are extremely expensive and frequently do not cross the multi-jurisdiction (but individually assessed by each state) hurdles with the net result that many potential "global" efficiencies are lost. These include multiple small benefits not justifying a regulatory application or agreements where most benefit accrues in one state only.

The Commerce Commission is required to balance any lessening of competition against the benefit to the public of the contract, arrangement or understanding. The Commission's discretion is very wide and includes having regard to many efficiencies that will likely result from the contract, arrangement or understanding *including improvements in international efficiency to the extent that they may cause gains from trade and investment which, from a long-run perspective, benefit the New Zealand public.* The efficiency and other gains which constitute public benefits must be able to be measured in money terms such as economies of scale and scope, better utilisation of existing capacity and cost reductions. Public detriment from cooperation agreements is a "given" starting point for the Commerce Commission's analysis. Proving anticipated economic benefits such as potential trade and tourism growth to the required standard is difficult and expensive. More importantly, "soft" benefits such as improved international relationships, more cultural exchange and enhanced efficiency of international aviation (not accruing directly to New Zealand) are not taken into account.

There is a further significant difference between the public benefit test that exists under the Commerce Act and the discretionary factors to which the Minister is required to have regard in exercising his discretion under the Civil Aviation Act when granting an authorisation. Under the Civil Aviation Act, the overriding criterion is ensuring that New Zealand's obligations under international aviation agreements are implemented. That obligation is set out in the Long Title to the Civil Aviation Act. In addition, in section 88(5) the Minister is permitted to authorise any provision of any contract, arrangement or understanding if he believes that to decline authorisation will have an undesirable effect on international comity between New Zealand and any other state.

This conflict between the respective policy objectives ASAs and competition law was, we believe the reason for the different legislative treatment of airlines and shipping. The Civil Aviation Act 1990 (s.88 (2)) allows the Minister of Transport to exercise a wide discretion in approving agreements related to international aviation, including air freight (cargo). Subsection 3 requires the Minister to have regard to "any international convention, agreement or arrangement to which New Zealand is a party". Section 88 does not ignore competition. Section 88 (4) prevents the Minister from approving agreements which include one or more of a number of anti competitive provisions, although that is subject to the over-riding consideration of any effect on international comity established by s.88(5) noted above.

Air New Zealand's experience of this process has been very positive and we believe the outcomes justify its continuation. The Ministry of Transport negotiates ASAs and has a deep understanding of international air transport and the related international conventions and agreements. It equally understands the importance of competition assessment. The Ministry's approach is rigorous and its subject matter expertise allows a much more efficient regulatory approvals process. Competition regulators on each occasion have to be "educated" about international aviation and generally require expensive economic analysis of the competition effects in various affected markets; all usually presented and argued by small armies of expensive lawyers and economists. The resulting analysis of competition has little regard to international

conventions, regardless of the fact that airlines, via the air services licences issued by ASAs have to comply with those conventions. At best a restriction on supply under an ASA will be considered, but usually counts against the applicant airlines. In addition, the resulting time and expense involved in such applications would inevitably deter airlines from seeking authorisation for certain agreements which would have resulted in net benefits for consumers but perhaps do not justify the time and expense of the traditional Commerce Commission authorisation process.

The undisputed major airlines market – including air freight services – is the USA. The USA has historically also lead the development of competition law. It is instructive to note that the regulatory solution to the conflict between international aviation and competition law adopted by the USA is the closest to the status quo in New Zealand. Under the Federal Aviation Act, the USA Department of Transport has exclusive jurisdiction in relation to international aviation agreements among airlines. The Department is required to consult with the USA Department of Justice as to the competition aspects of a proposed agreement, but the ultimate decision rests with the Department of Transport. Although not enshrined in regulation, it is understood that the New Zealand Ministry of Transport routinely seeks input from the Ministry of Economic Development as to the competition implications of an agreement – but the decision is ultimately for the Minister of Transport.

Our conclusion from considering the origins of the Civil Aviation Act regime (including in response to Q.39) is that the regime and its objectives continue to be justified. It meets the objectives of an efficient regulatory structure which balances New Zealand's international obligations in a complex and diverse international network industry with the needs of consumers through appropriate regard to maintaining competition.

Q.39 Should the regulatory functions in Part 9 of the Civil Aviation Act be the responsibility of the Commerce Commission rather than the Minister of Transport?

No.

We have addressed in responding to Q.38, explanations for the different treatment of international air freight and the following consideration of whether the functions of the Civil Aviation Act should remain with the Minister of Transport necessarily overlaps with the reasons for different treatment.

The introduction of what are now sections 88 to 91 of the Civil Aviation Act was first contemplated at the time of the introduction of the Commerce Act in 1986. The Commerce Act contained a transitional exemption until 1 March 1987 for international carriage by air to allow for a review of the appropriate competition regime for that industry. The regime contained in the Civil Aviation Act was the result of that review.

Passages from Hansard at the time of the introduction and subsequent readings of the Civil Aviation Amendment Bill 1987 make it quite clear that Parliament intended the Ministerial authorisations regime to limit the competition law concerns for consideration by the Minister when deciding whether or not to exercise his discretion

to grant an authorisation of tariff or capacity fixing arrangement to those matters specifically identified in section 88. At the time of the second reading of the Bill, the Minister said:

> "The New Zealand Government recognises that international aviation functions in a unique manner on a worldwide basis. Under its bilateral air service agreements with other States and other multi-lateral agreements and arrangements, New Zealand has accepted an obligation to provide a legal framework for the operation of international aviation to and from this country. The advent of the Commerce Act 1986 rendered unlawful, conduct that was otherwise basic to the interlocking international aviation network. However, in recognition of that position, transitional exemptions were provided within the Act to allow a review of an appropriate and workable competition regime for international aviation.
>
> The results of the review indicated that an exemption from the Commerce Act along the very broad lines of the transitional agreements provided under that Act would not be appropriate. It was then a matter of deciding the dividing line between those international aviation agreements and arrangements that should fall under the full scrutiny of domestic competition legislation, and those for which New Zealand's international aviation obligations and undertakings required additional factors to be taken into account. The various bilateral and multi-lateral inter-Governmental aviation agreements and arrangements to which New Zealand is a party relate mainly to capacity and/or tariffs, and to the means for those to be agreed and approved.
>
> Those are the two categories of international airline agreements and arrangements upon which the Bill focuses. A general exemption from the Commerce Act was not considered appropriate. **Rather, a scheme of authorisation has been devised to permit such agreements and arrangements to be exempted - but only when they are authorised by the Minister of Civil Aviation and Meteorological Services as being in line with New Zealand's international obligations and fair market practices. The circumstances in which fair trading practices are not deemed to be met are defined in the proposed new section 29A(4) in clause 2. They include anti-competitive situations that discriminate against consumers or other suppliers for international carriage by air.**" (emphasis added)

The Civil Aviation Act regime is based on the premise that the application of the broad competition law principles in the Commerce Act would preclude the authorisation of the IATA arrangements, multi-lateral and bi-lateral agreements, inter-airline practices and procedures on which international aviation was and remains dependent.

A submission in 1985 by Air New Zealand in support of the Civil Aviation Act regime considered the disruption that had resulted in the United States from the "Show Cause" order proposed by the (now defunct) Civil Aviation Bureau. The Bureau proposed to remove the immunity from United States anti-trust laws that IATA agreements had enjoyed since 1945 and to expose international carriers doing

business in that country to United States domestic competition legislation. The Bureau was persuaded not to pursue the proposal.

Air New Zealand also notes the New Zealand support for the resolution unanimously adopted by the 24th Assembly of the International Civil Aviation Organisation of the United Nations in 1983 which requested contracting states to avoid adopting unilateral measures which might affect the orderly and harmonious development of international air transport. This resolution is still in force.

The Commission, just like any commercial enterprise, is concerned with efficiency and we must consider this long standing regulatory regime in the context of the airline and airfreight industries today. We set out below a number of the competition and process issues relevant to the Commission's consideration:

1. Open Skies trends have removed many barriers to entry and been able to significantly advance competition within the context of the Ministry of Transport's policies.

2. International alliances that reflect the unique nature of the bi-lateral system have continued to evolve and be approved by the Minister (notwithstanding the constraints of the bilateral system) as a *de facto* for mergers and acquisitions which would otherwise have occurred.

3. Airline industry experience has shown that ability to maintain competition on a particular route is dependent on having reasonable financial returns. Contrary to open competition principles, fewer, more financially robust competitors managed in a flexible regulatory regime, will sustain competition.

4. The Ministry of Transport has competence in facilitating New Zealand aviation policy, both in terms of facilitating competition and taking an active role in policy development.

5. The need for speed, flexibility, cost efficiency and industry understanding is critical in approving alliances in an industry where opportunities to create important partnerships of value to New Zealand may be transitory.

6. The unique way in which international aviation functions including in particular, New Zealand's obligations under the resolution adopted at the 24th assembly of the ICAO in 1983, preclude the application of the Commerce Act.

7. The potential for disruption and the additional cost in removing the regime and requiring Commerce Act authorisation is not justified. The introduction of a Commerce Act regime would *probably* require authorisations to be gained under the Commerce Act for all existing arrangements that have been authorised under the Civil Aviation Act after some initial transitional period. This would impose a huge cost on the international airline industry in New Zealand.

8. The Ministry of Transport's familiarity with and understanding of New Zealand's obligations under international aviation agreements enable the Minister to consider the effects on international comity between New Zealand

and other states of declining an application for authorisation. These are not matters on which the Commerce Commission has expertise.

9. For almost 70 years international aviation has been governed by a system of bi-lateral air service agreements between countries. There are now some 3,000 air service agreements worldwide, most including airfreight with passenger services. They specify the terms and conditions under which airlines (of the countries which are parties to the bi-lateral air service agreements) can fly to and from and between each country. Unlike trade in goods, which is generally free unless specifically restricted, trade in international air services is prohibited unless specifically allowed by various "freedoms of the air" in ASAs.

   Restrictions on trade in goods are imposed unilaterally by a country and generally applied informally to all trading partners that are members of the World Trade Organisation. Restrictions on international air services, in contrast, are imposed bi-laterally within an international framework of bi-lateral agreements and are excluded from the World Trade Organisation's General Agreement on Trade in Services. Unless and until the international system of bi-lateral and multi-lateral agreements comes to an end, a different approach from the Commerce Act's principles continues to be required for approval of agreements, to take account of New Zealand's international aviation obligations.

   These are not matters on which the Commerce Commission has expertise.

These considerations support the position that it is preferable to retain the Civil Aviation Act regime rather than have the authorisation of these arrangements or alliances determined by the Commerce Commission under the Commerce Act.

Q.40 Does the Cargo Agents' Commission Regime perform an active and useful function in the international air freight services? Who does it benefit? Is the exemption from the Commerce Act required to achieve that function?

The current legal proceedings issued by the Commerce Commission (*ref Issues Paper p.45*) have highlighted the divergence in attitude to New Zealand's international obligations between the Commerce Commission and the Minister of Transport. Cargo commission regimes have been referred to in similar proceedings and investigations such as that by the European Commission. In our view, the Ministry of Transport is likely to have need in future of the powers in section 89 to authorise commission regimes. Such regimes are still provided for under a number of ASAs, particularly those that require compliance with IATA tariff setting processes.

Q.41 Has S.90 of the Civil Aviation Act been used in practice? What are the arguments for retention of the ability of the Minister to issue a tariff?

Contrary to the Commission's comments on s.90, it is routinely used to approve tariffs which are required by ASAs to be filed with the Ministry of Transport. Such tariffs may represent a small part of airlines' revenues as market driven fares very greatly dominate in the commercial environment. Nevertheless the filing of tariffs approved by overseas regulators remains an obligation of airlines and failure to do so

leaves them vulnerable to the kind of technical, capricious proceedings by the Commerce Commission currently being defended at the cost of tens of millions of dollars to New Zealand taxpayers.

Q.42 To what extent are the current regulatory arrangements adequate to deal with the investigation and prosecution of collusive behaviour in international air freight services?

To the extent that such collusive behaviour occurs – and some airlines have admitted illegal conduct in relation to fixing surcharges – the current regulatory arrangements are adequate. The existence of the Civil Aviation Act regime has not prevented the Commerce Commission commencing proceedings against airlines for collusive conduct not authorised by the regime. We note for the record however Air New Zealand's continued defence of those proceedings on the basis that it was not a party to any conduct or agreement that required authorisation.

Q.43 Do the current regulatory and competition regimes that affect international air freight transport services work well, or not, for New Zealand exporters and importers?

Yes, but subject to the comments in this submission and we note from our indirect involvement with exporters and importers that in a wider regulatory context, they need better co-ordination of security, border protection and quarantine agencies in New Zealand. The lack of co-ordination results in considerable duplication of effort and cost – ultimately borne by consumers.

Q.44 Is there a case for the different regulation of air freight services vs. sea freight services?

No – they should both benefit from a similar regime reflecting their similar international dimensions. As commented earlier, shipping services, particularly on the Tasman routes are regarded as competitors to air freight providers. The regulatory structure for airlines creates a material cost and administrative burden which shipping competitors do not suffer. A blanket exemption for international aviation from the Commerce Act with regulatory supervision solely the domain of the Ministry of Transport would be significantly more efficient.

Q.45 What lessons can New Zealand learn from the different ways that competition law and regulators in other countries deal with international air freight services?

This question can be equally considered in the context of airports and passenger services as well as air freight services.

No other country has the utterly insane legislation that allows airports to set prices as they see fit. There are simple and efficient means to redress that and Air New Zealand has submitted extensively to successive New Zealand Governments for over 20 years about the need for change. The current solution will not – at least in the medium term – stop excessive charging by airports. One day a government will

demonstrate courage on this issue. Until then New Zealand consumers and our international trade and tourism will continue to suffer inflated costs.

In the airlines context, the regulated regimes stemming from the origins of the international airline industry are at odds with the market driven philosophies of competition. The industry is littered with examples of contradictions in law and government policy which at one level demand compliance with anti competitive policies and practices and at another, with the requirements of competition law. Within the restricted rights of ASAs, airlines have to establish that joint activities, designed to limit the effects of anti competitive government restrictions, are pro-competitive and good for consumers. Few industries have to balance such dichotomies.

The regulatory approach in the USA, reflected in New Zealand appears to have given USA airlines efficient outcomes in most cases. In the rapid change from a highly regulated to a de-regulated industry commencing in the 1970s, many airlines failed. Those that adapted survived – often despite occasional Chapter 11 bankruptcy – and competed. As the industry has grown many have been forced to and have been permitted to amalgamate, particularly in recent years. The USA Department of Transport has a thorough understanding of the industry. One can't help but wonder what the outcome would have been if amalgamation authorisation had been the sole province of the Department of Justice which has on occasions been publicly, strongly opposed to the Department of Transport's decisions.

In many international treaties (for example Kyoto and WTO matters), aviation is treated as outside the "norm" for the reason that it has so many of its own complexities and tests the limits of national sovereignty. Consider for example the current intense international opposition to the European Union imposing carbon taxes on airlines from other countries operating in non-European airspace (but *en route* to the EU).

In our submission, regulation of international airlines is best left to those who truly understand it and are part of the system. New Zealand has frequently shown international leadership in moving away from restrictive ASAs to open skies ASAs allowing liberal access by airlines to New Zealand. Trade and tourism have grown accordingly with a measured approach to liberalisation of the right origin markets. The Ministry of Transport has the jurisdiction to manage this evolution and should retain it with an enhanced ability to improve its efficiency by waiving certain requirements completely without leaving a residual, default jurisdiction with the Commerce Commission.

The inefficiency in this area arises from the lack of policy alignment between two branches of Government. The Civil Aviation Act sets up a structure which works efficiently to recognise and manage the variety and complexity of international aviation agreements. Where those arrangements create bureaucratic inefficiency or there is a procedural oversight (but the purpose of the Act is nevertheless met as regards the interests of consumers) there should not be the scope that exists for the

Commerce Commission to prosecute "non-filed" agreements without the opportunity for the Ministry of Transport to intervene or even grant retrospective authorisation.

The present structure, but for that discrepancy, in our view creates:

> *"....the best balance between competition and coordination."*

In conclusion, there are a number of easy and simple improvements to regulation affecting international airfreight, Some are within the power of the New Zealand Government to fix – others require more of the leadership we have been able to show in the past, working with other states to develop efficiencies in our international air transport systems.

Yours faithfully

John Blair
General Counsel & Company Secretary

APPENDIX

1.1 The contents of this schedule are:

OVERVIEW OF AIR NEW ZEALAND LIMITED 3

Corporate and legal structure 3

Cargo operations in New Zealand 3

International cargo operations 3

Routes and frequencies 4

Types of cargo 4

Cargo volume 4

HOW AIR NEW ZEALAND'S CARGO BUSINESS OPERATES 4

Transport of Goods from Origin to Destination 4

Rates 6

Air Waybills 9

Capacity 9

Arranging Shipments 12

Who does Air New Zealand regard as its customers? 13

Marketing 15

Websites 15

APPENDICES

Appendix A - Air New Zealand's annual passenger and cargo revenue 17

Appendix B - List of countries with GSAs 18

Appendix C - Routes and Frequency Outbound from New Zealand and Routes and Frequency Inbound to New Zealand 20

Appendix D – Air New Zealand Routes 27

2. OVERVIEW OF AIR NEW ZEALAND LIMITED

Corporate and legal structure

2.1 Air New Zealand operates passenger, cargo, ground handling, and engineering services businesses, but is principally a passenger airline.[1] Its cargo business is a unit of the company, rather than a separate legal entity. In the year to 30 June 2009, Air New Zealand's passenger revenue was NZ$3,734 million and its cargo revenue was NZ$374 million (i.e., 10% of passenger revenue).[2]

Cargo operations in New Zealand

2.2 TEAL first flew from New Zealand in April 1940 and NAC first flew within New Zealand in April 1947. Both airlines carried passengers and cargo.

2.3 In addition to its passenger operations, Air New Zealand currently has cargo offices in Auckland, Christchurch and Wellington with a total of 48 staff in administrative, sales and managerial roles. The cargo business unit also has responsibility for 192 staff who undertake ground handling operations in New Zealand for Air New Zealand and other airlines.

International cargo operations

2.4 In addition to its passenger operations, Air New Zealand currently has a total of 48 cargo staff in offices in Australia (6 staff) in Brisbane, Melbourne, and Sydney; the Pacific Islands (6 staff) in Apia, Nadi, and Rarotonga; Japan (2 staff) in Tokyo; Hong Kong (6 staff); China (3 staff) in Shanghai; the United States (20 staff) in Atlanta, Chicago, Los Angeles, New York and San Francisco; and the United Kingdom (5 staff) in London. These staff are primarily in sales and administrative roles because operational requirements are contracted to third party ground handling companies overseas.[3] Air New Zealand also sells its services to freight forwarders in offshore markets via General Sales Agents (GSAs) in the countries listed in Appendix B

---

1 As a result, passenger service requirements are the primary factor in any decisions about routes, aircraft type, flight frequencies, etc.

2 A table showing Air New Zealand's passenger and cargo revenue for the years 1999 to 2009 is attached as Appendix A.

3 Except in the Cook Islands, where Air New Zealand does its own ground handling.

2.5 Air New Zealand has also had offices in Seoul, Singapore, Taipei and Frankfurt, with a small number of cargo staff, but stopped flying to or from these cities in 1997, 2006, 2006, and 2009 respectively.[4]

Routes and frequencies

Routes

2.6 A table showing the countries to and from which Air New Zealand flew and the frequencies for each direct and indirect route between 1999 and 2006 is attached as Appendix C.[5]

2.7 A route map showing the routes currently flown by Air New Zealand is attached as Appendix D.

Freighter services

2.8 Freighter services were provided by contracting with third party airlines (rather than by using an Air New Zealand aircraft). All freighter services ceased in March 2009.

Types of cargo

2.9 It is difficult to reliably identify the types of cargo carried to and from New Zealand because a review of air waybills shows that the recorded description of the goods for a high proportion of consignments (more than 50% outbound from New Zealand and more than 80% inbound to New Zealand) is general, such as "consolidations" or "express", and does not identify the goods carried.[6]

2.10 Air New Zealand was able to carry large oversized "maindeck" items (such as horses, vehicles, aircraft engines and other large pieces of machinery) on its freighter service between 1999 and 2006.

3. HOW AIR NEW ZEALAND'S CARGO BUSINESS OPERATES

3.1 Air New Zealand's cargo business consists of selling outbound air cargo services from an origin airport to a destination airport for goods exported from the countries in which Air New Zealand operates (within Air New Zealand, this is commonly referred to as selling "capacity" or "space"). Air New Zealand sells air cargo services in the countries of origin to freight

---

4 Passenger flights to or from Frankfurt stopped in 2001. Freighter services stopped in March 2009

5 The figures given in Appendix C are the total recorded flights on an annual basis.

6 Security requirements for such shipments are addressed through "known shipper" requirements, i.e., the freight forwarder must be "known" to the airline and must meet the security requirements.

forwarders, who bundle it with a range of other services to supply a total logistics package to their customers.

3.2 Air New Zealand also deals with some New Zealand exporters and has occasional contact with some importers.

3.3 The financial performance of Air New Zealand's cargo office in each country is measured only by the revenue collected from the sale of outbound air cargo services. The overall financial performance of Air New Zealand's cargo operations is in turn measurable by aggregating the revenue collected from the sale of outbound air cargo for each cargo office. Air New Zealand's cargo offices do not sell inbound air cargo services and do not receive, or account for, revenue from inbound air cargo services.

Transport of Goods from Origin to Destination

3.4 The exporter (or "shipper" or "consignor") of the goods contracts with a freight forwarder at origin for the delivery of the goods to the importer (or "consignee") at the destination. The importer may also arrange the delivery of the goods with a freight forwarder at destination which in turn deals with a freight forwarder at origin to arrange delivery from the origin.[7] The services typically provided by the freight forwarder to the exporter (or importer) include some or all of:

(a) collection of the goods from the exporter;

(b) temporary storage at origin;

(c) packaging for shipment;

(d) delivery of the goods to the airport;

(e) completion of all Customs, biosecurity and export clearance requirements;

(f) completion of the air waybill (**AWB**) on behalf of both the airline and the exporter (the Montreal Convention requires AWBs to be completed by the consignor);

(g) purchasing air cargo services from airlines and arranging for the physical transport of the goods from the origin airport to the destination airport;

(h) (through the freight forwarder at the destination), completion of all Customs, biosecurity and import clearance requirements;

---

7 From Air New Zealand's point of view, the freight forwarder at origin will often be the consignor and the freight forwarder at destination will be the consignee, e.g., when dealing with consolidated shipments.

(i) temporary storage at destination;[8] and

(j) delivery to the importer or collection by the importer from a freight forwarder at destination.

3.5 The carriage of goods from the origin airport to the destination airport is purchased by the freight forwarder from Air New Zealand. The freight forwarder at origin pays Air New Zealand for its air cargo services, irrespective of whether the exporter or the importer was initially responsible for arranging the shipment.

3.6 Freight forwarders in origin countries negotiate with multiple airlines in those origin countries for the carriage of goods from the origin airport to the destination airport. Air New Zealand's offices in each country have established relationships, including agreed rates and sometimes allocations of capacity, with those freight forwarders.[9] Air New Zealand's offices also provide its AWB stock (or "open" AWBs) to those freight forwarders. The key elements of the relationship between Air New Zealand and freight forwarders – rates, AWBs, capacity and the process of arranging shipments – are discussed below.

Rates

Types of rates

3.7 The Air New Zealand office in each country issues rate sheets to freight forwarders in that country, setting out prices for each destination served by Air New Zealand, weights (by either volumetric measure or per container), and levels of service.[10] These rate sheets are sometimes known as "contract rates". Air New Zealand has both general contract rates, applicable to all IATA-accredited freight forwarders, and specific contract rates for particular freight forwarders. The prices are in the currency of the issuing country.[11]

3.8 The rate sheets form the basis of most dealings with freight forwarders, but freight forwarders will often negotiate "ad hoc" or "spot" rates, usually at lower rates: e.g., when another airline offers lower rates or when it is known that cargo volumes on a particular

---

8 A number of freight forwarders now provide logistical services, known as "3PL" and "4PL", which can involve warehousing and delivery of goods directly to a company's retail outlets on an "as needed" basis.

9 In New Zealand, Air New Zealand charges gross rates and pays a commission on those rates to freight forwarders. Overseas, Air New Zealand charges net rates and does not pay a commission to freight forwarders. Freight forwarders apply margins to the net rates when charging their customers.

10 This occurs approximately every six months, coinciding with changes in flight schedules between the "Northern Hemisphere summer season" and "Northern Hemisphere winter season". Air New Zealand does not offer "bundled rates", i.e., for the purchase of air cargo services in both directions (but see also footnote 21).

11 The United States dollar is used as the currency for shipments from Costa Rica, Mexico, Puerto Rico, Israel, Indonesia, and the Philippines, as well as from the United States.

sector or route are low. Higher rates than contract rates may be negotiated also, e.g., when the freight forwarder has a large shipment or the shipment is particularly complex and not accommodated by the standard rates framework. Rate setting therefore remains a dynamic process as supply and demand changes.

3.9 For certain unusual types of cargo such as human remains, Air New Zealand charges "TACT rates", which are those rates shown in the TACT Manual published by IATA.

3.10 In addition to cargo rates, following increases in fuel costs in 1999 and a direction from Air New Zealand's executive to the regional cargo managers to consider whether fuel surcharges or rate increases were possible, Air New Zealand implemented fuel surcharges at different times in different countries and regions.

Market driven approach to setting rates

3.11 Air New Zealand's approach to setting rates was (and is) market driven. Air New Zealand does not take a "cost-plus" or cost-based approach to rate setting.[12] This is reflected in the business model for the cargo business, which set a revenue (not profitability) target for each cargo office, measuring the revenue collected from the sale of capacity outbound from that country,[13] so that costs (which in many cases were not within Air New Zealand's control) were not relevant to cargo rates, sales targets, and strategies.

3.12 The primary factors taken into account by Air New Zealand in setting or negotiating rates include:

(a) amount of capacity available on the route (directly or indirectly from origin to destination);[14]

(b) level of demand for cargo services on that route;

(c) market intelligence about the rates of competitors;

(d) the nature of the particular shipment, i.e., perishable cargo, live animals, dangerous goods, and oversized items (which could be charged at different rates from general cargo because of the additional requirements involved);

---

12 See paragraphs 3.17 to 3.18 below regarding marginal cost considerations and fuel surcharges.

13 Even revenue from "charge collect" shipments (i.e., where payment is collected at destination) is credited to the origin country office, not to the office where payment is collected.

14 Not all indirect routes are commercially viable alternatives to direct routes. For example, sending a shipment Auckland-Sydney-Los Angeles may be a viable alternative for a direct Auckland-Los Angeles route, but Auckland-Dubai-London-Los Angeles is unlikely to be a viable alternative.

(e) the level of service required, i.e., priority, close-off times prior to departure, and availability for collection at destination;

(f) features of Air New Zealand's services that made its flights more attractive than competitors (e.g., from some countries, such as the United Kingdom, Air New Zealand's arrival time to New Zealand was very early in the day, such that some customers would pay a higher rate because it enabled shipments to be delivered on the same day);

(g) the volume of business the freight forwarder purchased (i.e., customers that purchased more capacity usually had lower rates);[15] and

(h) for cargo from some parts of Australia and the Pacific Islands, the rate being charged by sea freight providers, because some customers could send cargo by sea if the difference was too great.

3.13 In addition, in Hong Kong and Japan, approval for surcharges was required from the local aviation regulators, the Hong Kong Civil Aviation Department and the Japan Civil Aviation Bureau respectively.

Costs

3.14 **Passenger belly hold services:** As Air New Zealand is primarily a passenger airline, the costs of carrying cargo are marginal because each flight is travelling in any case. As well as the costs of running the cargo sales offices, including salaries, premises leases, and administrative costs, the costs associated with carrying cargo include the additional fuel costs resulting from carrying the cargo, maintenance costs for the containers used to carry the cargo, and unloading costs for the cargo.

3.15 There was interaction between rates and costs in two respects:

(a) Although there were no prescribed minimum rates, cargo managers were aware that rates should cover marginal costs.

(b) Air New Zealand in some cases sought to recover increased fuel costs through fuel surcharges applied to the passenger and cargo businesses.

3.16 **Freighter services:** In contrast to the position with cargo travelling in the belly hold of passenger aircraft, Air New Zealand closely monitored the costs of providing its freighter service because the cargo business was incurring the total costs of providing that service. If revenue earned from freighter flights did not exceed the cost of those flights then the service was incurring a loss and was liable to be discontinued. However, Air New Zealand's ability

15 The geographic location of the freight forwarder's customer is not a relevant factor.

to set rates for the freighter service was constrained by exactly the same factors that applied to setting rates for cargo carried on passenger flights (i.e., by the market factors set out above). The additional costs faced by the freighter service went to the profitability of that service, but did not influence the rates that could be charged.

Air Waybills

3.17 The AWB is the international standard document typically required by international conventions (most recently the Montreal Convention) for all transport of cargo by air. It is a valuable document (the equivalent of a blank passenger ticket) and airlines account for each AWB issued by them. Air New Zealand issues its AWBs to the freight forwarders with which it has established relationships and where it is confident there are proper arrangements for the security and use of the AWBs.

3.18 Air New Zealand's offices issue AWBs to freight forwarders at origin. They are not issued to freight forwarders at destination. Each AWB is designated by a unique 11 digit serial number, including a code identifying the issuing airline ("086" for Air New Zealand), which enables Air New Zealand to identify and account for every AWB. The AWB also provides a unique reference used to manage every shipment of cargo across all the parties involved in the delivery of that shipment.

Capacity

Capacity supply

3.19 Air New Zealand has cargo capacity in the belly hold of its passenger flights[16] and purchases additional capacity through block space arrangements with third party airlines as demand for capacity varies. Air New Zealand might purchase additional capacity for a particular flight or flights, or on a certain route or routes, for example to meet seasonal demand in different markets or to accommodate its own fleet or schedule changes where they affect its belly hold capacity. For part of the relevant period, Air New Zealand also acquired capacity by leasing a freighter aircraft.

3.20 In some cases, Air New Zealand may also purchase additional capacity by contracting a third party trucking company to truck cargo under bond over part of the route recorded on an AWB. This can occur to extend Air New Zealand's network, where there are capacity constraints on a particular flight (the cargo will not fit on a narrow-bodied aircraft), or where additional capacity is needed (flights are full). For example, cargo to be transported from Atlanta to Auckland might be trucked from Atlanta Airport to Los Angeles Airport and then

[16] Route or network planning (i.e., decisions about which routes to fly) is carried out by computer modelling. Passenger considerations are the primary factors in the decision-making. Cargo considerations are also a factor but because passenger revenue is much greater than cargo revenue (see paragraph 2.2) they are a minor factor.

flown to Auckland Airport or cargo to be transported from Wellington to Brisbane might be trucked from Wellington Airport to Auckland Airport and then flown to Brisbane Airport.

Capacity demand (sales)

3.21 The Air New Zealand offices sell capacity to freight forwarders in three ways, seeking to tailor its service to the requirements of different customers:

(a) A "**hard block space**" arrangement is an ongoing arrangement (usually for a period of months or years) to sell a specified amount of capacity on a particular route and/or particular flights at an agreed rate. The freight forwarder usually pays for the capacity whether or not it uses it. Hard block space arrangements were rare for Air New Zealand.[17]

(b) An "**allocation**" (usually in place for a period of months) ensures that capacity is available on a particular flight or flights each week or month, but the freight forwarder only pays for the capacity it uses. If the freight forwarder does not confirm use of the capacity by a specified time before flight departure, then the capacity will be sold to another freight forwarder on an ad hoc basis (or, if it cannot be sold, the aircraft will fly with that allocation empty). If allocations were not used sufficiently, they could be reduced or removed by Air New Zealand. Allocations were also called a "permanent booking" or an "allotment" in some countries.

(c) "**Ad hoc**" or "**spot**" capacity is space sold without an allocation or hard block booking.

3.22 The proportion of capacity sold on a block space, allocation, or ad hoc basis for any specific flight depends on the interplay between the available capacity and the demand for that capacity on a sector or route at any given time. This is a dynamic process (even over a short timeframe), so that it is difficult to generalise about the proportion of capacity sold on each basis.

3.23 Demand is variable, even up to the time of departure, because block space capacity (even if paid for) may not be required, leaving some to be sold on an ad hoc basis, allocation capacity may also be "handed back", and ad hoc sales are used to try to fill the last available space. Cargo managers recognise that capacity is "perishable" in the sense that, once the aircraft has departed, any unsold capacity is permanently lost. This creates commercial

[17] Block space agreements are negotiated separately for each route. On one occasion in 2002 Air New Zealand offered a freight forwarder a discounted rate for its existing two pallets of capacity from Auckland to Los Angeles in exchange for that freight forwarder taking on new business, namely, four pallets of capacity from Los Angeles (two pallets to Melbourne and two pallets to Auckland). However, the proposal was not accepted because the freight forwarder said it was able to get better ad hoc rates from Los Angeles to Auckland.

pressure to sell the last kilogram of capacity at the best price that can be obtained in the market (without undermining the airline's pricing strategies).[18]

3.24 As well as variability of demand, the proportion of capacity available to be sold on a block space, allocation or ad hoc basis is also affected by operational and commercial factors. For example:

(a) Most cargo is carried on passenger flights, on which passengers and their baggage have priority. The capacity available to the cargo business to be sold and carried in the belly hold of passenger flights therefore depends on the weight of the passengers and the volume and weight of their baggage on each flight.[19] Although there will usually be capacity available, the exact amount of capacity often will not be known until shortly before the flight is due to depart.

(b) Operational conditions can also affect the maximum capacity that a flight can safely carry, e.g., weather conditions (such as an adverse head wind) may mean that total payloads are restricted. In circumstances where passengers and their baggage have priority, those restrictions further affect the capacity available to the cargo business. Again, often this will not be known until shortly before the flight is due to depart.

(c) Freight forwarders with a hard block booking or an allocation may take less, or want more, than the capacity available to them, so that on any given flight there is more, or less, capacity available to be sold on an ad hoc basis.

(d) Cargo that is "bumped" or "offloaded" from a particular passenger flight may have to be carried on another flight or, if there is insufficient capacity available on a suitable flight, the cargo manager may have to buy interline cargo capacity on another airline.

(e) Freight forwarders' requirements change as they win and lose customers or win and lose particular pieces of business.

(f) Freight forwarders' requirements also change according to the time of year or season, e.g., freight forwarders may want allocations of capacity for fresh produce during the growing season but only purchase capacity on an ad hoc basis at other times of the year.

(g) The proportion of capacity sold on a block space, allocation, or ad hoc basis also depends very much on the level of capacity being offered by other airlines, i.e., it varies as supply on each route varies over time. On many of the routes flown by Air

---

18 See also paragraph 3.18(a).

19 For example, on a Boeing 777 flight from Auckland to Los Angeles, Air New Zealand might carry approximately 30 tonnes of passengers and their baggage, 12 tonnes of cargo, and 98 tonnes of fuel.

New Zealand, its small size and capacity relative to other larger airlines mean that most capacity is sold on an ad hoc basis.

(h) On the freighter service, there was also variability in the proportion of capacity sold on a block space, allocation, or ad hoc basis across different sectors because of variable demand across each sector, e.g., there may be high demand for allocations from Frankfurt to Chicago and from Auckland to Melbourne but low demand for allocated space from Chicago to Auckland, Melbourne to Shanghai, and Shanghai to Frankfurt.

Arranging Shipments

3.25 To arrange a shipment, the freight forwarder at origin will contact the Air New Zealand office in that country, usually by telephone or email.[20]

3.26 If the freight forwarder has an allocation of space on the flight or there is capacity available, Air New Zealand will confirm the booking. If (in the rare case) the freight forwarder does not have existing contract rates agreed with Air New Zealand, then the freight forwarder would be charged Air New Zealand's general rate applicable to all IATA registered freight forwarders. If the freight forwarder is seeking an ad hoc or spot rate, the freight forwarder and Air New Zealand would negotiate a rate for the shipment. (Often a freight forwarder will contact a number of airlines seeking the best price, and will pass on to Air New Zealand the rates offered by other airlines during negotiations).

3.27 Having selected the airline, the information that the freight forwarder provides to Air New Zealand includes:

(a) the nature of the products or goods that make up the shipment (which may sometimes be a consolidation by the freight forwarder of smaller shipments for a number of the freight forwarder's customers, i.e., exporters or other freight forwarders);

(b) the weight and dimensions of the shipment (this is required for pricing and logistics, e.g., how the shipment will be packed and loaded onto the aircraft);

(c) whether it will be delivered to the cargo facility ready for loading onto the aircraft or whether it will require further packing (e.g., loading onto a pallet or into a standard container or "unit load device" (**ULD**) with other shipments);

(d) whether there are special packaging or handling requirements, e.g., for perishable shipments (such as foodstuffs or medical products), live animals, or dangerous goods;

---

20 Air New Zealand has a website for air cargo services, but services cannot be booked or arranged through the website. See further at paragraphs 3.65 to 3.69 below.

(e) when the shipment will be delivered to the cargo facility or ground handling agents for processing;

(f) the level of service or "product" required (e.g., whether the freight forwarder requires an urgent service or guaranteed uplift on a particular flight);

(g) the destination of the cargo; and

(h) a completed AWB for the shipment.

3.28 On arrival at the destination airport, the aircraft is unloaded by ground handling agents.[21] The ground handling agents will make the goods available to the origin freight forwarder's counterpart at destination (as specified on the AWB). That counterpart (another freight forwarder) deals with completion of Customs, biosecurity and import requirements, possibly temporary storage, and delivery to the consignee (occasionally the consignee may collect the goods from the ground handling agents and make arrangements for completion of entry requirements itself).

Who does Air New Zealand regard as its customers?

3.29 Air New Zealand considers that it has four types of customer:

(a) As explained above, both in New Zealand and overseas, Air New Zealand sells outbound air cargo services to freight forwarders at origin and is paid by those freight forwarders.

(b) In New Zealand, Air New Zealand also works with New Zealand exporters alongside freight forwarders in what are known as "tri-partite arrangements". Air New Zealand regards these exporters as customers also, although it does not sell the air cargo services to the exporters and is not paid by them.

(c) In New Zealand, the public can approach Air New Zealand's office at the airport and arrange shipments (such as unaccompanied luggage) outbound from New Zealand. In the Cook Islands, Samoa, Los Angeles, Singapore, Frankfurt, and London, Air New Zealand's ground handling agents have also provided the same service for shipments outbound from each of those airports.

(d) Both in New Zealand and overseas, Air New Zealand carries "interline" cargo for other airlines.

---

21 In New Zealand, Air New Zealand has a separate business function (within the company) that provides ground handling services to Air New Zealand and other airlines. Other companies that provide ground handling services to airlines in New Zealand include Menzies Aviation.

3.30 Outbound from New Zealand, for the period from 2000 to 2006,[22] Air New Zealand's twenty largest customers are IATA-accredited freight forwarders:

CONFIDENTIAL	

3.31 Outbound from all overseas origins to New Zealand, for the period from 2000 to 2006, Air New Zealand's twenty largest customers are also IATA-accredited freight forwarders:

CONFIDENTIAL	

[22] Data is not available for 1999.

3.32 Importers are not Air New Zealand's customers in New Zealand or overseas – Air New Zealand does not sell air cargo services to them and is not paid by them.[23]

MARKETING

3.33 Air New Zealand's cargo business depends on the strength of its relationships with freight forwarders and, in New Zealand, with freight forwarders and exporters.

3.34 Each cargo office sells export or outbound capacity and its financial performance is measured by revenue for those sales alone. This is reflected in Air New Zealand's marketing material, which is either generic, emphasising Air New Zealand's brand and service quality, or export focused. Air New Zealand has not produced marketing material that relates to imports or inbound services to New Zealand. The level of marketing of cargo services in New Zealand and overseas is low.

3.35 In New Zealand, Air New Zealand Cargo sponsors Export New Zealand and its regional Export Awards in Auckland and Canterbury. Air New Zealand hosts exporters and/or freight forwarders at the Export Awards.

Websites

3.36 Air New Zealand has had a website since prior to 1999 (www.airnewzealand.co.nz in New Zealand, with parallel sites in other countries). The international cargo page is www.airnewzealand.co.nz/international-cargo. Air cargo services cannot be booked or arranged through Air New Zealand's website.

3.37 The international cargo page contains:

(a) contact details for Air New Zealand's overseas cargo offices;

(b) details of Air New Zealand's services and conditions of carriage;

(c) products and services information (including information about pet services, perishable shipments, unaccompanied baggage, valuable/fragile cargo, cargo containers, dangerous goods, product overview, and the "Go Priority", "Go Express" and "Go General" services);

(d) cargo timetables, with a link to a searchable timetable system and information about carrying cargo in the "belly hold" of passenger flights; and

---

[23] See paragraphs 3.50 to 3.51 and 3.63 to 3.64 regarding contact between importers in New Zealand and Air New Zealand.

(e) regulatory compliance information about New Zealand Customs requirements, Ministry of Agriculture and Forestry directions, United States Customs procedures, United States Food and Drug Administration requirements, etc.

Appendix A

Air New Zealand's annual passenger and cargo revenue

Passenger and Cargo Revenue – 1999 to 2009 (NZ$ million)[24]											
	2009	*2008*	*2007*	*2006*	*2005*	*2004*	*2003*	*2002*	*2001*	*2000*	*1999*
Passenger	3,734	3,808	3,479	3,088	2,911	2,792	2,871	2,922	3,181	2,742	2,395
Cargo	374	416	396	359	297	286	296	286	317	317	388

[24] The revenue figures are for the year to 30 June of each year.

Appendix B

List of countries with General Sales Agents

Austria

Belgium

Canada

Czech Republic

Denmark

Finland

France

Germany (only GSA from Mar 09)

Holland

Hungary

India (no longer in place since Dec 05)

Indonesia

Ireland

Israel

Italy

Japan

Korea

Malaysia

Mexico

New Caledonia

Norfolk Island

Norway

Philippines

Poland

Singapore (only as GSA from date line flights ended 30 Sep 06)

Spain

Sweden

Switzerland

Tahiti

Taiwan

Thailand

Tonga

Turkey

Ukraine

United Kingdom

United States

Vanuatu

Appendix C

Routes and Frequency Outbound from New Zealand

Key

AKL Auckland
CHC Christchurch
WLG Wellington
ZQN Queenstown

Destination	Route	Frequency							
		1999	2000	2001	2002	2003	2004	2005	2006
Australia									
Adelaide (ADL)	AKL/ADL								122
Brisbane (BNE)	AKL/BNE	451	1012	645	480	391	491	838	883
	CHC/AKL/BNE		18	52					
	CHC/BNE	375	384	355	336	123	241	398	454
	WLG/BNE	345	346	310	279			225	332
	ZQN/BNE		16	10	11	11	11	11	25
Cairns (CNS)	AKL/CNS	42	52	51	93	104	121	131	170
Melbourne (MEL)	AKL/MEL	651	1128	1125	734	782	1056	958	551
	CHC/AKL/MEL			19	25				
	LAX/AKL/MEL								259
	CHC/MEL	364	370	366	367	378	523	466	438
	RAR/CHC/MEL							40	12
	WLG/MEL	281	282	396	385	365	364	366	365
	ZQN/MEL		16				11	11	13
Norfolk Island (NLK)	AKL/NLK	56	55	94	106	111	104	104	107
	CHC/AKL/NLK	52	52	12					
Perth (PER)	AKL/PER	123	147	111	196	209	246	295	324
	CHC/AKL/PER			52	12				
Sydney (SYD)	AKL/SYD	1410	1463	1337	1125	1759	1772	1777	1731

Destination	Route	Frequency							
		1999	2000	2001	2002	2003	2004	2005	2006
	CHC/AKL/SYD			37	50				
	CHC/SYD	743	735	732	839	759	772	734	710
	WLG/SYD	677	676	679	784	613	640	640	622
	ZQN/SYD	52	53	52	52	68	79	93	93
Pacific Islands									
Apia (APW)	AKL/APW	63	112	114	137	162	165	2000	217
Nadi (NAN)	AKL/NAN		56	217	199	217	242	281	286
	AKL/RAR/NAN	39	12						
	CHC/AKL/NAN			31					
	WLG/NAN							25	
Niue (IUE)	AKL/IUE							11	57
Noumea (NOU)	AKL/NOU	62	100	65	119	111	119	106	106
	CHC/AKL/NOU			38					
Papeete (PPT)	AKL/PPT	11	47	44	54	69	89	117	62
	AKL/NAN/RAR/PPT	52	52	15	30				
Rarotonga (RAR)	AKL/RAR	60	144	205	198	199	209	374	330
	AKL/NAN/RAR		30			52	52	53	52
Tongatapu (TBU)	AKL/TBU	61	55	135	202	210	230	291	279
Asia									
Hong Kong (HKG)	AKL/HKG	168	191	207	259	317	366	338	253
	CHC/AKL/HKG			39	43				
Nagoya (NGO)	AKL/NGO		27	96	120	136	148	150	36
	AKL/NAN/NGO	113	57						
	CHC/AKL/NAN/NGO	43	24						
	CHC/AKL/NGO		34	63	42				
Osaka (KIX)	AKL/KIX	137	181	254	292	292	290	296	285
	CHC/AKL/KIX	52	41	82	42				
	AKL/NAN/KIX	104	85						

Destination	Route	Frequency							
		1999	2000	2001	2002	2003	2004	2005	2006
	AKL/NRT/KIX				33	57	52		
Singapore (SIN)	AKL/SIN	113	116	157	243	271	366	368	303
	CHC/AKL/SIN				53	74			
	CHC/SIN	364	338	209	72				
Taipei (TPE)	AKL/TPE	183	153	99	73	138	172	108	
	CHC/AKL/TPE		10	19	43				
Tokyo (NRT)	AKL/NRT	260	262	223	291	307	303	361	355
	CHC/AKL/NRT			39	13				
Americas									
Honolulu (HNL)	AKL/HNL	92	55	155	140	156	148	136	148
	AKL/NAN/HNL	39	22	30					
	AKL/TBU/APW/HNL	29							
	AKL/TBU/HNL			31					
Los Angeles (LAX)	ALK/LAX	102	109	164	212	465	435	371	124
	CHC/AKL/LAX		17				25		
	MEL/AKL/LAX								259
	CHC/LAX						26	75	39
	AKL/NAN/HNL/LAX	59	53	12					
	AKL/APW/HNL/LAX	23	40						
	AKL/APW/LAX			43					
	CHC/AKL/NAN/RAR/ PPT/LAX			37	13				
	AKL/NAN/LAX	87	12	92	105	150	157	155	160
	AKL/PPT/LAX	52	58	134	115	54	43		
	AKL/RAR/HNL/LAX	52	43						
	AKL/RAR/LAX		20	91	96				
	AKL/RAR/PPT/LAX	52	24		18	154	158	152	166
	CHC/AKL/RAR/PPT/LAX		19						

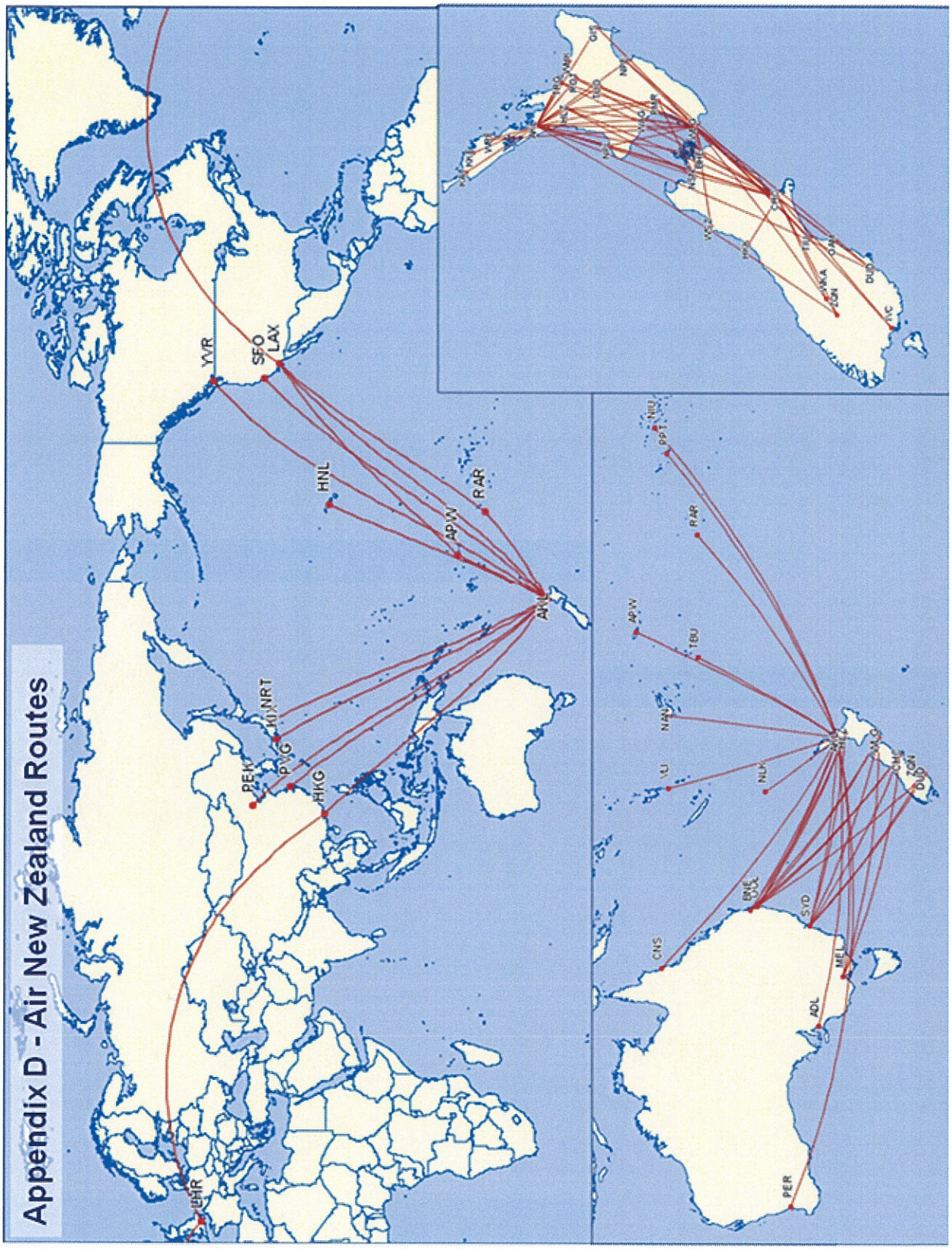
Destination	Route	Frequency							
		1999	2000	2001	2002	2003	2004	2005	2006
	AKL/TBU/APW/LAX			10	51	52	38	52	52
	AKL/TBU/HNL/LAX	23	50	12					
San Francisco (SFO)	AKL/SFO						81	172	327
Vancouver (YVR)	AKL/HNL/YVR	38	79	52					
	AKL/NAN/HNL/YVR	13	30	13					
Europe									
London (LHR)	AKL/LAX/LHR	364	362	365	356	352	366	366	365
	AKL/HKG/LHR								65
Frankfurt (FRA)	AKL/NAN/LAX/FRA	17	68	23					

Routes and Frequency Inbound to New Zealand

Origin	Route	Frequency							
		1999	2000	2001	2002	2003	2004	2005	2006
Australia									
Adelaide (ADL)	ADL/AKL								121
Brisbane (BNE)	BNE/AKL	452	1032	697	475	387	494	820	884
	BNE/CHC	364	381	356	337	122	242	398	452
	BNE/WLG	345	345	310	280			225	332
	BNE/ZQN	11	16	10	11	11	11	11	25
Cairns (CNS)	CNS/AKL	54	52	51	93	104	114	131	168
Melbourne (MEL)	MEL/AKL	663	1130	1145	762	783	1059	959	554
	MEL/AKL/LAX								255
	MEL/CHC	365	368	368	365	377	525	466	423
	MEL/CHC/RAR							40	29
	MEL/WLG	282	282	396	385	366	365	365	366
	MEL/ZQN		16				11	12	13
Norfolk Island (NLK)	NLK/AKL	107	73	63	107	111	104	104	107
	NLK/AKL/CHC			31					
	NLK/AKL/WLG		34	12					
Perth (PER)	PER/AKL	122	156	163	208	109	246	295	321
Sydney (SYD)	SYD/AKL	1421	1458	1369	1179	1765	1779	1787	1734
	SYD/CHC	731	734	732	735	760	772	732	716
	SYD/WLG	676	677	679	680	613	640	639	623
	SYD/ZQN	64	52	52	52	68	79	93	91
Pacific Islands									
Apia (APW)	APW/AKL	62	112	117	135	162	170	198	217
Nadi (NAN)	NAN/RAR/AKL	39	13						
	NAN/AKL		57	253	200	220	248	279	291
	NAN/WLG							25	
Noumea (NOU)	NOU/AKL	60	109	103	110	113	117	106	105

Origin	Route	Frequency							
		1999	2000	2001	2002	2003	2004	2005	2006
Papeete (PPT)	PPT/AKL	14	56	54	55	69	90	113	61
Rarotonga (RAR)	RAR/AKL	58	177	203	199	200	210	374	328
	RAR/CHC/MEL							40	12
	RAR/NAN/AKL					52	52	53	52
Tongatapu (TBU)	TBL/AKL	58	60	136	201	212	229	294	277
Asia									
Hong Kong (HKG)	HKG/AKL	170	191	246	302	317	368	335	254
Nagoya (NGO)	NGO/AKL		47	156	161	136	148	148	36
	NGO/NAN/CHC/AKL	52	12						
	NGO/NAN/AKL	104	85						
Osaka (KIX)	KIX/AKL	78	87	167	184	147	149	146	130
	KIX/CHC	32							
	KIX/NAN/AKL	72	52						
	KIX/NAN/CHC/AKL	33	11						
Singapore (SIN)	SIN/AKL	104	114	157	296	346	366	368	302
	SIN/CHC	365	339	208	72				
Taipei (TPE)	TPE/AKL	182	163	118	116	123	127	94	
Tokyo (NRT)	NRT/AKL	105	106	104	111	108	109	186	202
	NRT/CHC							32	12
	NRT/KIX/AKL				68	101	96	24	
	NRT/CHC/AKL	154	156	157	154	149	153	123	141
	NRT/CHC/AKL	79	156	168	152	146	153	150	154
Americas									
Honolulu (HNL)	HNL/AKL	94	31	159	139	158	148	136	149
	HNL/NAN/AKL	35	10	30					
	HNL/TBU/AKL			31					
Los Angeles	LAX/HNL/TBU/AKL	23	53	12					

Origin	Route	Frequency							
		1999	2000	2001	2002	2003	2004	2005	2006
	LAX/AKL	159	102	152	214	474	459	366	118
	LAX/AKL/MEL								259
	LAX/APW/AKL			43					
	LAX/HNL/APW/AKL	23	43						
	LAX/CHC						17	43	35
	LAX/CHC/AKL							33	
	LAX/HNL/NAN/AKL	40	52	12					
	LAX/NAN/AKL	87	55	101	104	149	157	157	156
	LAX/PPT/RAR/NAN	52	51	51	43				
	LAX/PPT/AKL	52	72	134	115	55	44		
	LAX/HNL/RAR/AKL	52	34	12					
	LAX/PPT/RAR/AKL	53	33		18	153	157	155	157
	LAX/RAR/AKL		20	92	96				
	LAX/APW/TBU/AKL			10	52	51	51	52	52
	LAX/HNL/APW/TBU	29							
San Francisco (SFO)									
Vancouver (YVR)	YVR/HNL/AKL		43	13					
	YVR/HNL	18	25						
	YVR/HNL/AKL	49	83	52					
Europe									
London (LHR)	LHR/LAX/AKL	352	362	365	365	364	366	365	365
	LHR/HKG/AKL								64
Frankfurt (FRA)	FRA/LAX/NAN/AKL	16	34	12					
	FRA/LAX/AKL	13	36	12					


Appendix D - Air New Zealand Routes
YVR
SFO
LAX
HNL
RAR
APW
AKL
NRT
PEK
PVG
HKG
LHR
NAN
TBU
NLK
NOU
PPT
NIU
WLG
CHC
DUD
ZQN
BNE
SYD
MEL
ADL
CNS
PER