

Air New Zealand and United Airlines alliance amendment application

Reason for this briefing	Air New Zealand and United Airlines have jointly sought authorisation, under Section 88 of the Civil Aviation Act 1990, of a Side Agreement to an alliance previously approved by the Ministry of Transport in 2002.
Action required	Consider the evidence we have provided and decide whether to authorise the Side Agreement.
Deadline	None
Reason for deadline	None

Contact for telephone discussion (if required)

Name	Position	Telephone		First contact
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MINISTER'S COMMENTS:

Date:	21 October 2016	Briefing number:	OC04537
Attention:	Hon Simon Bridges	Security level:	In-Confidence

Minister of Transport's office actions

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| <input type="checkbox"/> <i>Noted</i> | <input type="checkbox"/> <i>Seen</i> | <input type="checkbox"/> <i>Approved</i> |
| <input type="checkbox"/> <i>Needs change</i> | <input type="checkbox"/> <i>Referred to</i> | |
| <input type="checkbox"/> <i>Withdrawn</i> | <input type="checkbox"/> <i>Not seen by Minister</i> | <input type="checkbox"/> <i>Overtaken by events</i> |

Purpose of report

1. Air New Zealand Limited (Air New Zealand) and United Airlines, Inc. (United), (together the Applicants), have sought authorisation under Section 88 of the Civil Aviation Act 1990 (the Act) of a Side Agreement to the Alliance Expansion Agreement (AEA) previously entered into between the Applicants and authorised by the Ministry of Transport in 2002.
2. As outlined in Section 88 of the Act, you have authority to authorise such arrangements.
3. We have prepared this briefing to outline the potential benefits and the potential detriments that authorising this Side Agreement could create. We have based our recommendation on whether the potential benefits of authorising the Side Agreement outweigh any potential detriments.

Executive Summary

4. In 2002, we authorised an AEA between Air New Zealand and United. The AEA enabled the Applicants to coordinate services across their networks. Some categories of fares on the Auckland to Los Angeles route were “carved out” from the scope of the authorisation (Carve-outs).
5. On 12 February 2016, the Applicants made a Side Agreement to the 2002 AEA, which we subsequently received on 14 June 2016. If authorised, the Side Agreement will remove the Carve-outs and allow the Applicants to coordinate all fares between New Zealand and the United States. The Applicants expect to submit a corresponding application to the United States Department of Transportation (USDOT) in the coming months. This process could take anywhere from three to nine months.
6. The Applicants outlined the following key reasons in their application for why the Side Agreement should be authorised:
 - current competitive conditions mean the Carve-outs are not necessary for protection of consumers
 - changes in industry fare structures and definitions have rendered the Carve-outs obsolete
 - removal of the Carve-outs will allow greater benefits to be generated by the alliance
 - removal of the Carve-outs will create a level playing field with competing trans-Pacific alliances.
7. We have concluded that the Side Agreement does not violate any of the specific prohibitions in the Act.
8. We have conducted an analysis considering the potential benefits or harm that could result from the removal of the Carve-outs. We received four submissions, which we considered during analysis of the Side Agreement.
9. Our analysis concluded that authorising the Side Agreement would have benefits that are not outweighed by any detriment to the public. This is because of existing competition in the Auckland to Los Angeles market, and the small size of the Carve-outs relative to the Agreement as a whole. Authorising the Side Agreement is likely to deliver public benefits in the form of more competitive fare pricing, better connectivity between New Zealand and the United States and improved reciprocal loyalty benefits for frequent flyers. It would also place

Air New Zealand and United on the same footing as Qantas Airways (Qantas) and American Airlines whose alliance agreement is not subject to the same carve-outs.

Background on the 2002 Alliance Expansion Agreement and the Side Agreement

Alliance agreements are a response to the international regulatory framework for aviation

10. International aviation is a highly regulated industry, governed by a network of thousands of bilateral air services agreements. These agreements set out (among other things) the routes and capacity that airlines can operate between any two countries, and the ownership criteria for the airlines of those countries. Consequently, airlines are often unable to expand into new markets, and cross-border mergers between airlines are rare and complex.
11. In order to overcome these restrictions, airlines are increasingly seeking to enter into deeper commercial relationships with one another. In particular, Air New Zealand, and a number of other airlines globally, have built their international strategies around integrated alliance agreements. Alliances are extensive commercial agreements in which two or more airlines agree to cooperate on all aspects of pricing, scheduling, and service delivery in a particular market.
12. Alliances allow airlines to share risk, pool their resources, and expand their 'virtual' route networks. However, alliances also come with substantial risks as they have the potential to reduce competition in a market.

The 2002 Aviation Expansion Agreement and the Carve-outs

13. In December 2001, Air New Zealand filed for authorisation of an AEA, with United, under Section 88 of the Act. The AEA provided for wide-ranging cooperation across the network operated by the carriers including code-sharing (in the form of a Code-Share Agreement) and tariff fixing.
14. The USDOT imposed a set of carve-outs on the AEA they received from the Applicants (on non-stop Los Angeles to Auckland flights). The application we received in 2001 reflected the carve-outs imposed by the USDOT, and prevented coordination in relation to certain Auckland to Los Angeles fares purchased in New Zealand.
15. The Carve-outs offered up by the Applicants were defined as:
 - 'pricing, inventory or yield management coordination, or pooling of revenues by the parties, with respect to unrestricted coach-class (economy class) fares or any business or first-class fares for local New Zealand-point-of-sale passengers flying non-stop between Auckland and Los Angeles or
 - the provision by one party to the other of more information concerning current or prospective fares or seat availability for such passengers than it makes available to airlines and travel agents generally'.
16. We produced a report in February 2002 concluding that the AEA did not contravene relevant sections of the Act. It also concluded that the AEA had the potential to deliver a range of benefits to consumers travelling to and from New Zealand as well as offering growth opportunities for the New Zealand tourism market. We consequently authorised the AEA, under delegation of the then Minister of Transport.

17. Under the Carve-out definition, we have considered the passengers affected to be those who travel solely from Auckland to Los Angeles on non-stop services operated by Air New Zealand, who bought their tickets in New Zealand.
18. Exceptions allowed for joint development, promotion, or sale by the Applicants of certain discounted, corporate and government fare products.
19. The USDOT rationale for imposing carve-outs on the AEA was to avoid potential competition issues created for time sensitive (particularly business) passengers travelling on Auckland-Los Angeles and Auckland-Sydney services.

United stopped operating its own aircraft to New Zealand in 2002

20. United stopped operating its own aircraft on United States-New Zealand routes in 2002. However, this cannot be attributed to the AEA. The operating environment facing all airlines, and particularly those from the United States, was particularly difficult in the wake of the September 2001 terrorist attacks. In July 2016, United recommenced operating its own aircraft and currently operates non-stop services from San Francisco to Auckland, a route also served by Air New Zealand.

Cooperation between the applicants has expanded under the scope of the existing authorisation

21. [] Air New Zealand and United have been deepening their cooperation on routes between New Zealand and the United States under the terms of their existing authorisations. In December 2015, Air New Zealand began operating services to Houston and, in July 2016, United began operating services from San Francisco to Auckland. The parties have agreed pricing and capacity coordination between Auckland and San Francisco, and to United States cities served from San Francisco. Negotiations continue for expansion of cooperation on other routes and other elements (for example marketing and advertising, revenue sharing) with the objective of 'metal neutrality'. 'Metal neutrality' is a Joint Venture in which the airlines become effectively indifferent to which plane or 'metal' carries a passenger. This form of cooperation typically involves full coordination of the major airline functions on the affected routes, including scheduling, pricing, revenue management, marketing and sales.

The Side Agreement

22. We received the application for authorisation of the Side Agreement from the Applicants in June 2016. The Side Agreement provides that the Carve-outs will cease to apply. Removal of the Carve-outs will allow the Applicants to coordinate their activities in relation to all fares between New Zealand and the United States.

The Applicants have outlined four key reasons for authorisation of the Side Agreement

Current competitive conditions mean the Carve-outs are not necessary for protection of consumers

23. The absence of overlapping own-aircraft services between Air New Zealand and United on the carved-out Auckland to Los Angeles fares and the direct, and indirect, competition provided by the American Airlines/Qantas and Delta/Virgin Australia alliances mean that the Carve-outs are not required to protect consumers.

Changes in industry fare structures and definitions have rendered the Carve-outs obsolete

24. The Carve-outs preclude coordination on “unrestricted coach-class fares” and “business or first-class fares”. Due to changes in the fare structure since 2002, which has seen selling return fares as a combination of two one-way fares become common practice, the Carve-outs now have a much broader application than originally intended. (Refer to paragraphs 47 and 48 for a more detailed explanation of the changes in fare structure).

Removal of the Carve-outs will allow greater benefits to be generated by the Alliance

25. The Applicants would be able to jointly promote the service from Auckland to Los Angeles, increasing the potential for in-bound tourism. Removal of the Carve-outs would enable the Applicants to match tactical fare reductions initiated by competitors on the Auckland to Los Angeles route and freely discuss pricing and revenue sharing for other New Zealand to the United States routes.

Removal of the Carve-outs will create a level playing field with competing trans-Pacific alliances

26. The Carve-outs prevent the Applicants from providing a fully coordinated offering in competition with the Qantas/American Airlines and Delta/Virgin Australia alliances. These alliances have been authorised to fully coordinate on all routes without the Carve-outs that were imposed on the Applicants.

Civil Aviation Act 1990

27. Section 88 of the Act states that ‘the Minister may from time to time specifically authorise all or any provisions of a contract, arrangement, or understanding made between two or more persons in respect of international carriage by air and related to such carriage so far as the provisions relate, whether directly or indirectly, to the fixing of tariffs, the application of tariffs, or the fixing of capacity, or any combination thereof’.
28. The effect of such an authorisation is that sections 27 to 29 of the Commerce Act 1986 (which relate to arrangements substantially lessening competition) do not apply to any arrangements so authorised.

Specific Statutory Considerations

29. In 2002, we determined that the AEA did not breach any of the prohibitions in sections 88(3) or 88(4) of the Act. That analysis remains valid. In the current case, the decision you are being asked to make is whether authorisation of the provisions of the Side Agreement is permitted by the Act.
30. Sections 88(3) to 88(5) of the Act set out considerations which the Minister of Transport (or delegate) must take into account when considering an application for authorisation of any contract, arrangement or understanding, pursuant to the Act. Each of these considerations and an analysis of the relevant parts of the Side Agreement are specified in turn below.
- (i) ***The Minister shall ensure that the granting of such authorisation will not prejudice compliance with any relevant international convention, agreement, or arrangement to which the Government of New Zealand is a party (s.88(3))***

Both New Zealand and the United States are party to the Multilateral Agreement on the Liberalization of International Air Transportation (MALIAT). The MALIAT explicitly

provides for the sort of code-sharing and other cooperative arrangements covered by the AEA and thus the Side Agreement. The MALIAT also provides that tariffs shall not be subject to approval.

- (ii) ***Authorisation shall not be given to any provision that provides for any party to the contract, arrangement or understanding to directly or indirectly enforce it through any form of action by way of fines or market pressures against any person (s.88(4)(a))***

The Side Agreement does not have any provisions that provide for it to be enforced through fines or market pressures.

- (iii) ***Authorisation shall not be given to any provision that has the purpose or effect of breaching the terms of a commission regime issued under section 89 of the Act (s.88(4)(b))***

The Side Agreement does not have the purpose or effect of breaching the terms of a commission regime (it has no provisions relating to commissions or the commission regime).

- (iv) ***Authorisation shall not be given to any provision that unjustifiably discriminates between consumers of international air services in the access they have to competitive tariffs (s.88(4)(c))***

The Side Agreement does not contain any provision that unjustifiably discriminates between consumers of international air services in the access they have to competitive tariffs. The Side Agreement brings the mechanisms for setting tariffs on Auckland to Los Angeles services into line with that for other routes.

- (v) ***Authorisation shall not be given to any provision that, so far as it relates to tariffs, has the effect of excluding any supplier of international carriage by air from participating in the market to which the contract, arrangement or understanding relates (s.88(4)(d))***

The Side Agreement does not have the effect of excluding any supplier from participating in the market.

There are no explicit provisions in the Side Agreement, which relate to carriers other than Air New Zealand and United. The Side Agreement alters the way the two Applicants participate jointly in the Auckland to Los Angeles market but does not prevent any other carrier from doing so.

The Qantas/American Airlines Alliance operates non-stop services on the Auckland to Los Angeles route (with American Airlines aircraft). The airlines entered the route at a time when Air New Zealand and United were also increasing their operations on routes between Auckland and points in the United States.

As set out elsewhere in this report, a number of airlines offer one-stop services between Auckland and Los Angeles. These airlines will remain able to do this. If the

Applicants attempted to raise prices on the route, it would make other airlines' services a more attractive alternative.

- (vi) ***Authorisation shall not be given to any provision that has the purpose or effect of preventing any party to the contract, arrangement or understanding from seeking approval, in terms of section 90 of the Act, for the purpose of selling international carriage by air at any other tariff so approved (s.88(4)(e))***

The Side Agreement has the effect of bringing the process for fares on the Auckland to Los Angeles route into line with all other point-to-point journeys. It does not actually specify the individual fare levels.

Clause 4.3 of the Code-Share Agreement between Air New Zealand and United (which applies to the Side Agreement) provides that they may each seek approval under s.90 of the Act for the purposes of selling international carriage by air at any other tariff so approved.

- (vii) ***Authorisation shall not be given to any provision that prevents any party to the contract, arrangement or understanding from withdrawing, on reasonable notice, without penalty (s.88(4)(f))***

The Side Agreement does not have an explicit end date. We have previously concluded that the termination provisions in the wider Alliance Expansion and Code-Share Agreements are consistent with this sub-section, in line with industry practice and consistent with other arrangements you have authorised. Following the expiration of an initial four-year term, the AEA can now be terminated by either airline on twelve months' notice.

31. As the Side Agreement does not breach sections 88(3) or 88(4) of the Act, consideration under section 88(5), which provides for the authorisation of a contract, arrangement or understanding notwithstanding the provisions of section 88(4) of the Act, on international comity grounds, is not relevant.

Approach to the Analysis of the Side Agreement

32. Our approach to the analysis of airline cooperative agreements consists of a public interest test to consider whether the benefits of the proposed arrangements would outweigh any costs or risks to consumers, or New Zealand as a whole, compared to the counterfactual (what is likely to occur if the proposed arrangements are not authorised).
33. Generally, the counterfactual is the world without the proposed alliance. In this case, the counterfactual is the alliance continuing, but with the Carve-outs remaining.
34. We have therefore largely confined our analysis to the potential benefits or harm that could eventuate as a result of authorising the Side Agreement, which removes the Carve-outs from the original AEA.
35. The major harm that could be caused by authorisation would be if it permitted the parties to increase fares on the Auckland to Los Angeles route. Our analysis looks at the number of passengers potentially affected by the removal of the Carve-outs, the extent of competition between airlines for these passengers, and the benefits from removing the Carve-outs. We have also addressed the issue of fairness between airlines and alliances.

36. In addition, we have considered the converse situation, where the Applicants may decide to reduce fare prices to below cost. This could potentially make one-stop airlines uncompetitive in the Auckland to Los Angeles market, in turn giving the Applicants market power and creating detriment for airlines such as Air Pacific and Air Tahiti Nui.

Competition in the Auckland to Los Angeles market

American Airlines has recently introduced non-stop flights from Auckland to Los Angeles

37. Air New Zealand has been the only carrier consistently operating non-stop services in the Auckland to Los Angeles market since United withdrew in 2002. However, in June 2016, American Airlines began operating non-stop flights from Auckland to Los Angeles, in conjunction with their joint-venture partner, Qantas. Due to the very short time that the American Airlines flights have been operating in the market, it is difficult to evaluate the effect of the added competition quantitatively.

Indirect competition exists in the market through one and two stop alternatives

38. In addition to the direct competition that has recently been introduced by American Airlines, the Applicants face indirect competition in the market from competitors offering one-stop flights from Auckland to Los Angeles. One-stop operators carried 31 percent¹ of Auckland to Los Angeles passengers in the 2015 financial year. A break down of the passengers can be seen in the table below.

Service type	Passenger	Percentage of Auckland to Los Angeles market
Total number of passengers travelling solely from Auckland to Los Angeles in the 2015/16 financial year	44,326	100%
Total number of passengers travelling solely from Auckland to Los Angeles on one-stop flights in the 2015/16 financial year	13,746	31%
Total number of passengers travelling solely from Auckland to Los Angeles on non-stop Air New Zealand services in the 2015/16 financial year	30,143	68%

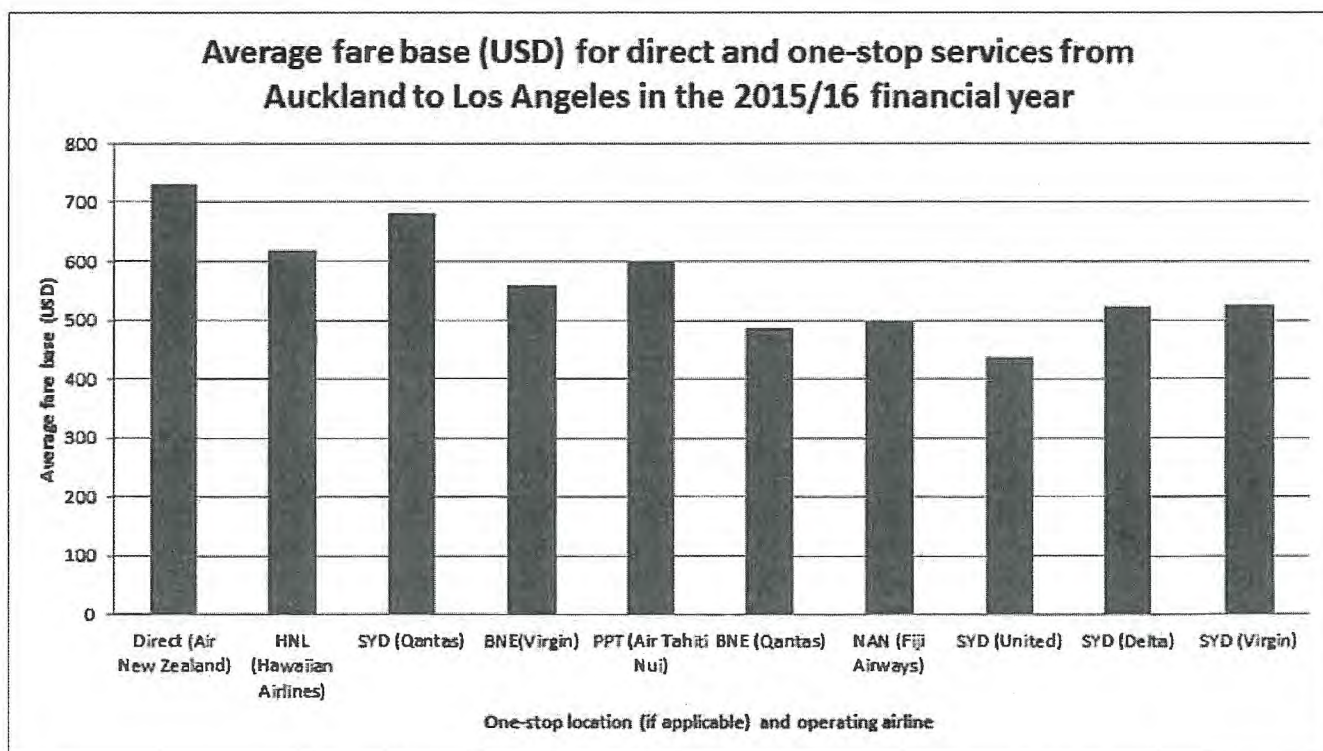
*1 percent gap caused by rounding and two and three stop flights.

¹ All data has been collected from Sabre AirVision Market Intelligence 5.9.0. Final data was used for the months July 2015 – May 2016 and preliminary data was used for June 2016.

39. The table below outlines nine different airlines operating one-stop flights for passengers travelling solely from Auckland to Los Angeles in the 2015/16 financial year.

Operating airline	Connecting airport	Number of passengers travelling solely from Auckland to Los Angeles in the 2015/16 financial year
HAWAIIAN AIRLINES INC.	HNL	1972
QANTAS AIRWAYS LTD.	SYD	1871
VIRGIN AUSTRALIA INTERNATIONAL AIRLINES	BNE	1621
AIR TAHITI NUI	PPT	1495
QANTAS AIRWAYS LTD.	BNE	1360
AIR PACIFIC LTD.	NAN	1301
UNITED AIRLINES INC.	SYD	1044
DELTA AIR LINES INC.	SYD	999
VIRGIN AUSTRALIA INTERNATIONAL AIRLINES	SYD	818

40. The graph below outlines the average fares for each of these flights for the 2015/16 financial year. All one-stop flights were cheaper on average than the direct service offered by Air New Zealand. We conclude that these flights have been acting as indirect competition, providing an alternative for passengers willing to sacrifice the convenience of a non-stop flight for a cheaper one-stop alternative.



41. It is our view that even if the American Airlines-Qantas Alliance were to withdraw from the Auckland to Los Angeles market, sufficient indirect competition would continue to exist in the form of one-stop flights to prevent a significant increase in fares.

Effects of the Applicants lowering their prices below cost price

42. The converse to the anti-competitive scenario, where the Applicants jointly raise prices on their Auckland to Los Angeles flights, is that they could decide to lower prices to a level that would make it unsustainable for competitors to remain in the Auckland to Los Angeles market. We do not consider that the Side Agreement materially increases this risk. We also note that authorisation under the Act does not provide an exemption from section 36 of the Commerce Act which relates to taking advantage of market power (including predatory pricing).
43. For one-stop competitors such as Air Pacific and Hawaiian Airlines, Auckland to Los Angeles passengers make up only around 5 percent of their total passengers. A decrease of prices on the Auckland to Los Angeles route would affect yields for these airlines but would not drive them from the New Zealand market entirely.

The percentage of passengers potentially impacted by the removal of the Carve-outs is relatively small

44. In the 2015 financial year, approximately 402,741 passengers travelled on Air New Zealand operated flights from New Zealand to the United States (including passengers whose origin was not New Zealand and whose final destination was outside of the United States). Of these 402,741 passengers, 30,143 (7 percent) had a journey that was solely Auckland to Los Angeles.
45. The Carve-outs apply only to passengers travelling on Auckland to Los Angeles non-stop point-to-point services who purchased their tickets in New Zealand. Although we have been unable to access a figure for passengers who fall within the Carve-outs, it is unlikely that many, if any, passengers would be purchasing Auckland to Los Angeles point-to-point fares outside of New Zealand or the United States. For the purpose of analysis, we assumed that on average, half of the Auckland to Los Angeles point-to-point fares are New Zealand point-of-sale. The actual figure is likely to be lower.
46. Consequently, we estimate that approximately 15,072 passengers travelled between Auckland and Los Angeles on tickets that were covered by the Carve-outs imposed by the New Zealand regulatory approval. These passengers represented approximately 3.7 percent of the entire alliance (15,072 passengers out of 402,741) in the 2015/16 financial year.

The Carve-outs are specified in a way that does not reflect contemporary pricing practices

47. The Carve-outs prevent coordination on “unrestricted coach-class fares” and “business or first-class fares”. The USDOT defined unrestricted fares as “published fares not requiring either a Saturday night stay or a minimum stay of seven days or more”. The stated intention was to protect business travellers whose lack of flexibility meant they were less able to take advantage of competing one-stop and connecting fares than more flexible travellers were.
48. Modern practice is to sell return fares as a combination of two one-way fares. Therefore, concepts such as a Saturday night stay are not reflected in pricing. Because of the uncertainty regarding the application of categories, the Applicants have been treating all Auckland to Los Angeles fares as being covered by the Carve-outs. It is thus having a much broader application than originally intended.

Competitor services are not subject to carve-outs

49. One of the factors which has influenced our approach to individual alliances over the past two decades has been our view that, given the size of the New Zealand market and our relative geographic isolation, consumers and travellers in New Zealand will benefit when there is strong competition between Qantas and its alliance partners on the one hand, and Air New Zealand and its alliance partners on the other. The growing presence of the Skyteam in New Zealand (particularly China Southern) is also encouraging.
50. On 8 November 2015, you authorised an expanded Joint Business Agreement (JBA) between Qantas and American Airlines. Under the expanded JBA, the airlines will coordinate their operations on trans-Pacific routes including coordination in respect of marketing and sales, freight, pricing, scheduling, distribution strategies including agency arrangements, yield and inventory management, frequent flyer programs, lounges, joint procurement and product and service standards. The JBA covers coordination of operations between and within Australia/New Zealand, and the United States, Canada and Mexico. There were no carve-outs or conditions applied to this authorisation. American Airlines is now operating services between Los Angeles and Auckland as part of the JBA.
51. There is an element of equity in allowing the Air New Zealand/United alliance to price on the same basis as the Qantas/American Airlines alliance.

Use of carve-outs in other jurisdictions

52. In some recent cases involving integrated Joint Ventures, USDOT (which as noted previously imposed the initial Carve-outs) has determined that carve-outs would inhibit the realisation of efficiencies and thereby the consumer benefits resulting from those efficiencies. The Australian Competition and Consumer Commission has also accepted that carve-outs can reduce the public benefits in some cases. The European Commission has no experience, to date, with carve-out remedies.

Submissions

53. We received submissions from Tourism New Zealand, Auckland Airport, Tourism Industry Aotearoa and Christchurch International Airport Limited.

Tourism New Zealand

54. Tourism New Zealand supported the authorisation of the Side Agreement. It indicated the need for a strong and competitive airline industry to maintain recent growth in airline capacity between New Zealand and the United States.
55. It outlined that the United States is our third largest tourism market, numbering 255,000 arrivals for the year-ending May 2016. It also noted that visitors from the United States are typically higher value, with an average spend of \$5,000 per visitor to New Zealand in the year ending March 2016, compared with the average visitor spend of \$3,490.

Auckland Airport

56. Auckland Airport expressed its support for the application. It agreed that changes since the AEA was authorised in 2002 have made the restrictions imposed by the Carve-outs less relevant. Auckland Airport also noted that due to the current market conditions on the routes affected by the Carve-outs, lack of competition is not a concern for consumers.

Tourism Industry Aotearoa

57. Tourism Industry Aotearoa wrote a letter in support of authorisation of the Side Agreement. In its view, authorisation of the Side Agreement aligns with its goal to grow sustainable air connectivity, which is a crucial pipeline for New Zealand's visitor industry. They acknowledged the importance of a level playing field for airlines operating in the market. Tourism Industry Aotearoa suggested that the Carve-outs are no longer required to protect consumers, and that removal of the Carve-outs will actually provide benefits to consumers. It also suggested that our analysis should consider how authorisation of the application would benefit the wider New Zealand economy.

Christchurch International Airport Limited

58. Christchurch International Airport Limited (CIAL) wrote a submission that contained suggestions for our analysis of the Side Agreement and questioned several points made by Air New Zealand in its application.
59. The first suggestion CIAL made was to encourage us to carry out a rigorous assessment of the Applicants' coordination under the existing AEA. It suggested that the benefits of the 2002 application need to be evidenced and need to outweigh any public detriment before the arrangements should be extended any further.
60. CIAL stated that the Applicants have not sufficiently addressed what evidence exists that the Side Agreement will result in benefit accruing to the New Zealand public, and whether the claimed benefits are unable to be achieved without the authorisation of an extension to an otherwise anti-competitive alliance.
61. CIAL commented that an alliance operating with the benefit of an anti-competitive authorisation is unlikely to be incentivised to deliver pro-competitive benefits. They claimed that the Applicants did not provide evidence in their application on the likelihood of pro-competitive benefits occurring, and the steps the Applicants have put in place to ensure they occur.
62. CIAL recommended we critically evaluate and determine the combined effect the Side Agreement and the AEA may have on the ability of other carriers to fly international air services to New Zealand, including to points of entry other than Auckland.
63. CIAL recommended that if the Side Agreement was to be authorised, that this be for the shortest period determined necessary to enable the claimed public benefits to occur, and only for so long as we are satisfied that they outweigh the public detriment.

Cross submission by the Applicants

64. We gave the Applicants an opportunity to make a written response to the submissions. In their response, the Applicants made the following points.
- The AEA has provided greater connectivity between New Zealand and the United States. This has given passengers greater variety of choice in their destinations and provided inbound tourism opportunities.
 - The AEA has improved reciprocal loyalty benefits for Air New Zealand and United frequent flyers.
 - Removing the Carve-outs will allow the Applicants to respond to tactical fares to ensure fares in the market are as low as they can be.

- Removing the Carve-outs will incentivise United to market tickets on the Auckland to Los Angeles route.
- Auckland to Los Angeles is a competitive market with no current overlap between United and Air New Zealand.
- Authorising the Carve-outs for a limited time would not be appropriate as the wording of the Carve-outs is obsolete, re-imposing Carve-outs would be practically difficult and no competitive benefits would result from re-imposing the Carve-outs.

65. We have used evidence provided in the Applicants' response in our consideration of the submissions.

Consideration of submissions

66. Three of the submissions supported the authorisation of the Side Agreement, and agreed with the reasoning presented by the Applicants. CIAL raised a number of concerns about the authorisation, which we have considered in turn below.

Evidence for the benefits of the AEA

67. CIAL suggested that in considering whether the Side Agreement should be authorised, evidence needs to be provided as to whether the Alliance as a whole has resulted in public benefits that outweigh any public detriment.

68. We consider that the correct counterfactual is the AEA with the Carve-outs remaining (as this would be what would happen if you declined authorisation). The market would not revert to a situation without the alliance. Nevertheless we have considered the benefits of the AEA as context to our analysis.

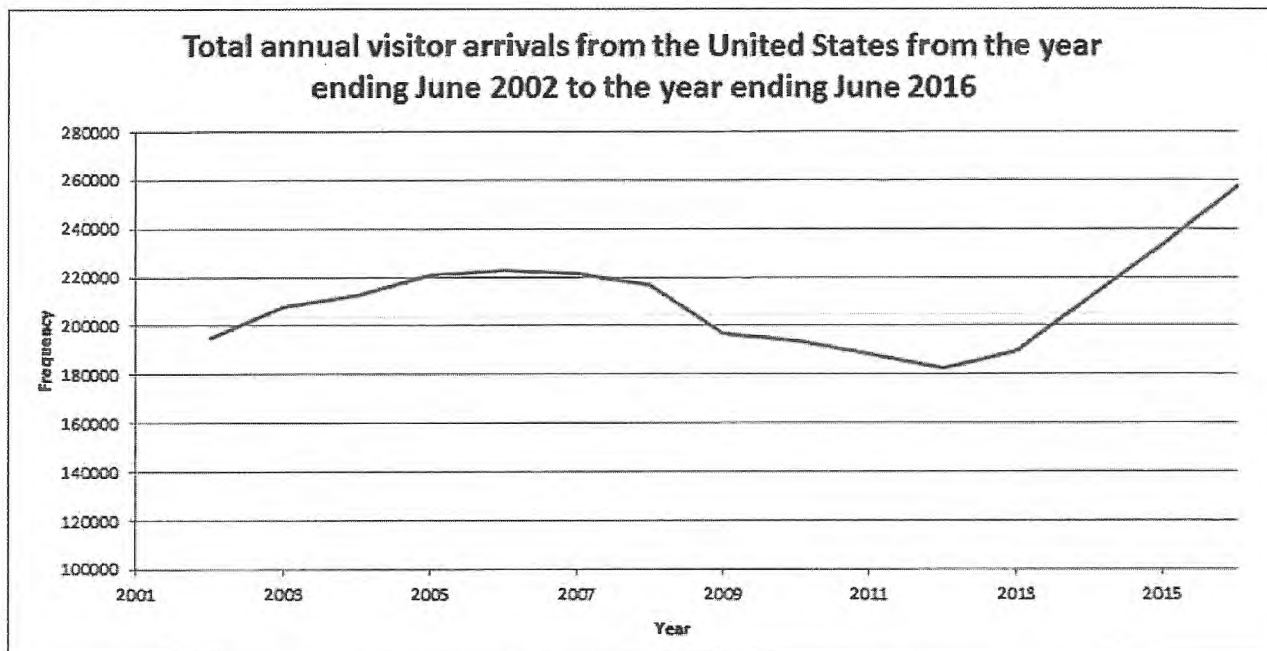
69. New Zealanders now have better access to the United States because of increased numbers of non-stop routes and services from New Zealand to the United States, and because of United's extensive domestic network that connects passengers to other places in the United States. Evidence of this includes the launch of Air New Zealand's Auckland-Houston service, which resulted in a 20 percent increase in total arrivals from Texas in the following six months. United's support has enabled better access for New Zealanders to other places in the United States, with [] percent of passengers connecting beyond Houston on United flights. Additionally United's launch of an Auckland-San Francisco route in July 2016 increased capacity on this route by 25 percent.

70. The Applicants claim that the Alliance has led to lower reciprocal interline billing rates, the benefit of which has been partially passed on to the public in the form of more competitive fares.

71. As part of the Alliance, Air New Zealand Airpoints members now earn and redeem points on United's Auckland-San Francisco service at the same rate as they do on Air New Zealand operated services. Likewise, United MileagePlus members accrue points at the same rate on Air New Zealand services as they do on United and have better access to redemption seats on Air New Zealand than previously. This is particularly important given the popularity of New Zealand as a reward destination.

72. It is difficult to evaluate quantitatively the benefits that have accrued to New Zealanders because of the Air New Zealand and United AEA. Many external factors drive the price of fares and the number of passengers travelling on certain routes alongside the existence of

the AEA. However, as shown in the graph overleaf², visitor arrivals from the United States have increased substantially overall since 2001. Although the effects of the 2001 terror attacks and the global financial crisis in 2008 are visible on the graph, since 2012, in a more stable and secure environment, visitor arrivals have steadily increased.



73. It is our view that compared to the counterfactual, which was suggested by CIAL, of having no AEA; the benefits outweigh the potential detriments. The benefits exist in the form of connectivity between New Zealand and the United States, the consistency of flights, lower fare offerings and reciprocal loyalty benefits.

Evidence for the benefits that will accrue to the New Zealand public because of the Side Agreement

74. CIAL questioned what evidence exists that the Side Agreement will result in benefit accruing to the New Zealand public and whether the claimed benefits are unable to be achieved by the New Zealand public generally without the authorisation of an extension to an otherwise anti-competitive alliance.
75. Removal of the Carve-outs will allow the Applicants to respond to competing promotional fares in the Auckland to Los Angeles market, ensuring that fares in the market are as low as they can be from all key participants.
76. Removing the Carve-outs will enable the Applicants to coordinate their fare offerings on Auckland to Los Angeles. It will also enable the Applicants to revenue share, which will incentivise United to promote the sector to the Los Angeles catchment, potentially leading to growth in visitation to New Zealand.
77. The Applicants claim that these tangible benefits cannot be achieved without the authorisation of the Side Agreement. We agree with this claim as the current conditions imposed by the Carve-outs have restricted the Airlines from producing these benefits. We are satisfied with the evidence presented to us that the Applicants will use the removal of the Carve-outs to ensure these benefits are realised.

² Data source: Statistics New Zealand International Travel and Migration - Visitor arrivals from US by state and purpose (Annual-Jun)

Ability for other carriers to operate international services to New Zealand

78. We do not consider that there would be any detriment caused by the Side Agreement on the ability for other carriers to operate international services to New Zealand. This applies to all points of entry in New Zealand.
79. In June 2016, American Airlines began operating non-stop flights between Los Angeles and Auckland. We do not believe this service will cease to operate if the Side Agreement is authorised. In fact, American Airlines would likely receive more of the market share if the Applicants were to raise their airfares because of the Carve-out removal.

Period of authorisation

80. The original AEA was authorised for an unlimited period. CIAL has suggested if this Side Agreement is authorised, it is done so for a limited period, during which the Applicants can prove that the benefits will be accruing to the New Zealand public.
81. Our analysis of whether the Carve-outs should be removed is based on a wider set of considerations than just current market conditions on the non-stop Auckland to Los Angeles route.
82. Authorising the Side Agreement for a limited period will only allow us to re-evaluate whether the Carve-outs should be re-imposed at the end of the allocated time (it would not provide for a re-examination of other elements of the AEA). We would not consider re-imposing the Carve-outs which have an obsolete wording.
83. In addition to this reasoning, re-imposing the Carve-outs would not make it any more likely for United or another carrier to enter the Auckland to Los Angeles market. It is also unlikely that there would be any public benefit in re-imposing the Carve-outs, since this would reduce the incentive that United has to market and sell tickets on the route.

Conclusion

84. After considering the application made by Air New Zealand and United, we have concluded that the Side Agreement should be authorised for an unlimited period.
85. We believe that this authorisation will allow the Applicants to fully realise the benefit of the initial AEA signed in 2002. Public benefits will be realised in the form of more competitive fare offerings, better connectivity with the United States, which provides more options to travellers and inbound tourism opportunities, and improved reciprocal loyalty benefits for frequent flyers.

Recommendation

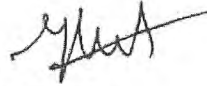
86. The recommendation is that you:

- a) **authorise**, pursuant to section 88(2) of the Civil Aviation Act 1990, all provisions of the 12 February 2016 Side Agreement to the Alliance Expansion Agreement between Air New Zealand and United Airlines

Yes No

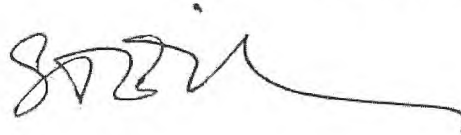


Genevieve Woodall
Adviser



Tom Forster
Manager Aviation and Security

MINISTER'S SIGNATURE:



DATE:

7 / 11 / 16