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Office Hon. Simon Bridges

## Authorisation of the Qantas/American Airlines Alliance

<b>Reason for this briefing</b>	To provide you with our final advice on the application by Qantas and American Airlines for authorisation of a joint business agreement (or 'alliance').
<b>Action required</b>	Agree to authorise the proposed Joint Business Agreement and associated agreements between Qantas and American Airlines.
<b>Deadline</b>	Tuesday 10 November 2015.
<b>Reason for deadline</b>	On Wednesday 11 November 2015, you will be attending an event to announce the launch of a new air service, to be operated by American Airlines between Los Angeles and Auckland. The new service is likely to be dependent upon you authorising the proposed joint business agreement (or alliance). Y

**Contact for telephone discussion (if required)**

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**MINISTER'S COMMENTS:**

<b>Date:</b>	6 November 2015	<b>Briefing number:</b>	OC03545
<b>Attention:</b>	Hon Simon Bridges (Minister of Transport)	<b>Security level:</b>	Commercially Sensitive

**Minister of Transport's office actions**

- |  |  |   |
|--|--|---|
| <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Withdrawn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. On 12 June 2015, Qantas and American Airlines (the applicants) submitted an application under the Civil Aviation Act 1990 (the Act), seeking authorisation of a joint business agreement and associated agreements (together, the 'alliance agreements').
2. Under the Act, you are responsible for authorising (or declining) applications for alliances and other cooperative arrangements between international airlines. This briefing provides you with our final advice on the application.

## Background

### *Alliance agreements in the international aviation industry*

3. Alliances are becoming increasingly common in the aviation industry as a way for airlines to pool their resources, share risk, and grow their route networks. Five integrated alliances have been authorised in New Zealand since 2010. These are between:
  - Air New Zealand and Virgin Australia, covering services between New Zealand and Australia
  - Air New Zealand and Singapore Airlines, covering services between New Zealand and Singapore and beyond Singapore to numerous countries in Asia, the Middle East and Europe
  - Qantas and Emirates, covering services between New Zealand and Australia and Dubai and beyond Dubai to numerous countries in the Middle East, Africa and Europe
  - Air New Zealand and Cathay Pacific, covering services between New Zealand and Hong Kong, and beyond Hong Kong to destinations in mainland China (primarily southern China)
  - Air New Zealand and Air China, covering services between New Zealand and China (primarily focussed on the Shanghai and Beijing markets).
4. Air New Zealand also has an alliance with United Airlines, which was authorised in 2002 for an indefinite period. This alliance covers destinations throughout North America, Central America and the Caribbean.
5. Alliances involve conduct that would typically be regarded as anti-competitive, and in breach of the restrictive trade practices provisions in the Commerce Act 1986. However, we have taken the view that alliances are often necessary to help airlines overcome restrictions imposed on them through bilateral air services agreements. As you will be aware, aviation is a highly regulated industry, and no airline in the world is able to serve all markets. In particular, most countries will not let foreign airlines provide domestic services. In countries with large domestic markets (such as the United States and China), airlines will find it very difficult to compete unless they enter into a commercial relationship with a local airline in order to gain access to its domestic network.
6. Nevertheless, each alliance needs to be carefully scrutinised to ensure that it delivers benefits that outweigh any reduction in competition.

## Summary of the proposed alliance

7. The proposed alliance provides a framework for Qantas and American Airlines to cooperate on all aspects of pricing, scheduling and service delivery on their respective services between New Zealand and North America (the United States, Canada and Mexico). Effectively, the two airlines would cease competing with each other on services between New Zealand and these countries.
8. Neither Qantas nor American Airlines currently operates a direct (non-stop) service between New Zealand and North America. As a result, cooperation would initially be limited to indirect services between New Zealand and the United States via Australia. Around 70 percent of passengers currently travel via Australia to get between New Zealand and the United States. The alliance would enable passengers to book a ticket from (for example) Wellington to Philadelphia, via Sydney and Los Angeles, involving flights operated by both Qantas and American Airlines. The airlines would jointly determine the price of the ticket, and share revenue in accordance with an agreed formula.
9. On 11 November 2015, American Airlines will be announcing its intention to launch a new non-stop service between Auckland and Los Angeles. This service would also be covered by the proposed alliance. We would not expect this new service to go ahead if the alliance is not authorised.

### *Existing authorisation*

10. The proposed alliance would supersede an existing alliance agreement between the airlines, which was authorised in 2010. The existing alliance agreement is a more limited code-sharing agreement. It does not permit the airlines to share revenue, which the applicants argue is necessary to enable them to compete with Air New Zealand and United Airlines (and with Virgin Australia and Delta in the Australia-North America market<sup>1</sup>).

### *Authorisations in other jurisdictions*

11. The alliance also requires authorisation in Australia (from the Australian Competition and Consumer Commission) and the United States (from the Department of Transportation). Neither organisation has announced its decision to date. We expect that the alliance will be authorised in Australia by the end of November. The United States Department of Transportation has sought additional information from the applicants. At this stage, it is not clear when it will make its decision. The alliance will need to be authorised in all three jurisdictions in order to be fully implemented. We have not identified any risks associated with you making your decision before the authorities in Australia and the United States.

## Framework for our analysis

12. The Act provides an exemption from the Commerce Act 1986 for cooperative arrangements between international airlines.
13. To be capable of being authorised, any and all provisions of agreements for which authorisation is being sought must meet the specific statutory criteria set out in section 88 of

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<sup>1</sup> Virgin Australia and Delta are party to a revenue-sharing alliance covering their services between Australia and North America. Neither airline operates services between New Zealand and the United States.

the Act. The Act also states that provisions can only be authorised to the extent that they relate directly or indirectly to the fixing of tariffs (fares), or the fixing of capacity.

14. In this case, we have confirmed that none of the relevant provisions breach the prohibitions in the Act. All provisions are therefore capable of being authorised to the extent they relate directly or indirectly, to the fixing of tariffs, the application of tariffs, or the fixing of capacity. A small number of sub-provisions relating to joint procurement fall outside the scope of authorisation and therefore cannot be authorised, but this will not prevent the alliance from being implemented.
15. You are not required to authorise an agreement merely because it passes all of the statutory tests
16. In order to advise you on whether or not authorisation of the alliance is in the public interest, we have undertaken a comprehensive analysis of the alliance. Our analysis has considered:
  - 16.1. the potential benefits to New Zealand that are likely to arise as a result of the alliance
  - 16.2. the potential risks and detriments associated with the alliance
  - 16.3. the counterfactual (i.e. what is likely to happen if you chose not to authorise the alliance).
17. Our detailed analysis of the alliance is provided as Annex A. The key conclusions of our analysis are summarised below.

#### **Likely benefits of the alliance**

*The alliance will enable the launch of a new direct service between Auckland and Los Angeles*

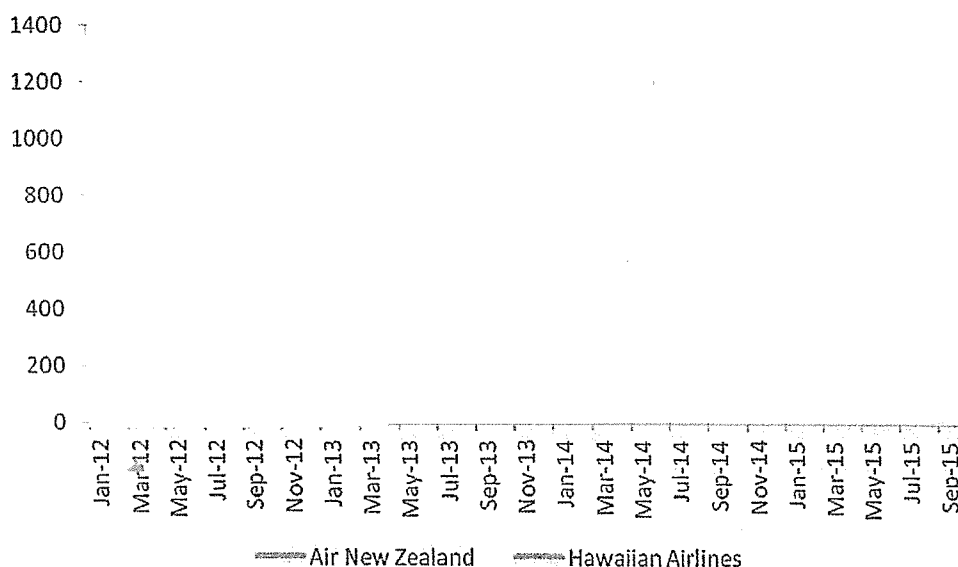
18. The market for air travel between New Zealand and the United States is typically regarded as uncompetitive. Air New Zealand is currently the only airline providing direct (non-stop) services between New Zealand and the United States mainland<sup>2</sup>. Limited competition is provided by Qantas, American Airlines, Virgin and Delta (via Australia), Hawaiian Airlines (via Honolulu), and Fiji Airways (via Nadi).
19. In December 2015, Air New Zealand will be operating 30 services per week between New Zealand and three cities in the United States mainland (Los Angeles, San Francisco and Houston), without any direct competition. In contrast, there will be around 85 services per week between Australia and the United States mainland, with five airlines competing in the market. Air New Zealand's share of the New Zealand-United States market is around 60 percent, while the largest airline operating in the Australia-United States market is with a market share of around 20 percent.
20. In July 2015, United Airlines will commence services between San Francisco and Auckland. However, this service will not compete directly against Air New Zealand. Air New Zealand and United Airlines have a pre-existing alliance in the United States market, which was authorised in 2003. As a result, the United Airlines service is unlikely to have a significant impact on Air New Zealand's ability to take advantage of its monopoly position.

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<sup>2</sup> Since 2013, Hawaiian Airlines has operated a non-stop service between Honolulu (Hawaii) and Auckland. However, due to the distance between Hawaii and the US mainland, and the leisure-oriented nature of the route, this is generally regarded as a separate market to the remainder of the North American market.

21. The proposed alliance will pave the way for a new direct (non-stop) service between Auckland and Los Angeles, operated by American Airlines. This service will be announced at a launch event on 11 November 2015.
22. Qantas and American Airlines have decided to announce this service before regulatory approval of the alliance has been granted. However, we believe that the new service is firmly linked to the proposed alliance. If you decline to authorise the alliance, we would expect Qantas and American Airlines to delay or cancel the launch of the service.
23. The new service is likely to deliver significant economic benefits to New Zealand. Direct competition between American Airlines and Air New Zealand on the Auckland-Los Angeles route is likely to result in more capacity and lower fares, which is likely to stimulate additional demand and increase the number of United States visitors travelling to New Zealand. To estimate the likely impact, comparisons can be made with the Auckland-Honolulu route, where Hawaiian Airlines' entrance onto the route resulted in a significant and immediate reduction in average fares (as shown in figure 1, below).

Figure 1: Average one-way fares between Auckland and Honolulu (\$US, all classes)



*The alliance would provide a strong competitive balance against Air New Zealand and United Airlines*

24. The alliance would provide a strong competitive balance to the existing alliance between Air New Zealand and United Airlines. The alliance provides both Qantas and American Airlines with the ability to sell connecting tickets on either side of the route, taking advantage of American Airlines' large domestic network in the United States, and Qantas' domestic network in New Zealand (operated under the Jetstar brand).
25. Strong competition between the two alliances would incentivise both airline groups to differentiate their products in order to provide a more attractive proposition to passengers and capture a greater share of the market. One way of achieving this is to develop direct services to additional destinations.
26. While services to/from additional airports (in either New Zealand or North America) are unlikely in the short-term, the alliance would increase the possibility of the applicants developing new services in the future. At the same time, the alliance is likely to incentivise

Air New Zealand and United Airlines to consider additional services to one or more of United Airlines' hubs (which include Chicago and Denver), or services from another airport in New Zealand (likely to be Christchurch). Without a strong competitor, Air New Zealand and United Airlines are more likely to consolidate their operations at the airports they already serve.

*The alliance will deliver other benefits that are commonly associated with alliances*

27. As with almost all alliances, the applicants propose to cooperate in areas such as premium customer handling and shared lounge access. They also intend to enter into a reciprocal frequent flyer scheme, which allows passengers of each airlines' loyalty scheme to 'earn and burn' frequent flyer points on flights operated by the other airline. This will allow the New Zealand-based members of Qantas' frequent flyer scheme to redeem their frequent flyer points on the new American Airlines service to Los Angeles.
28. As with previous applications, we have not placed significant weight on these benefits. Many of these benefits are likely to occur (albeit to a lesser extent) even in the absence of the alliance, as both airlines are members of the Oneworld global alliance<sup>3</sup> so already have incentives to cooperate with each other.

#### **Potential risks and detriments**

*The alliance may put pressure on existing services to North America, or deter other airlines from operating to New Zealand*

29. Any new air service is likely to attract passengers that may have otherwise travelled on a different service. In this case, the new American Airlines service to Los Angeles is likely to have an impact on all of the existing services between New Zealand and North America. This could affect the commercial viability of those services.
- 30.
- 31.
32. More generally, there is a long-term risk that the alliance could result in an effective duopoly on services between New Zealand and North America. Any other airline considering services to New Zealand may be deterred by the prospect of competing against two alliances involving airlines with a strong presence on both ends of the route. Currently, we are not aware of any other airlines (other than those already operating or intending to operate) that

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<sup>3</sup> Oneworld is one of three global airline alliances (the others are Star and Skyteam). Members of global alliances typically cooperate closely with each other in areas such as premium customer handling and frequent flyer programmes.

are seriously considering operating services between New Zealand and North America. The most likely candidate is Delta. However, the likelihood of Delta operating services to New Zealand in the short to medium term is low, regardless of whether the alliance is authorised.

33. Ultimately, we consider this issue to be a problem caused by the underlying characteristics of the New Zealand domestic market. The only way to avoid this issue would be to decline to authorise all alliance and code-share arrangements on services between New Zealand and North America (thereby ensuring a level playing field). We do not consider this to be a viable option.

### Counterfactual

*Without the alliance, competition is unlikely in the short term*

34. Qantas and American Airlines have not directly stated in their application that the soon to be announced service between Los Angeles and Auckland is dependent upon authorisation of the alliance. However, our view is that American Airlines is unlikely to launch the new service if the alliance does not go ahead.

J. In our view, it is also questionable whether American Airlines would be able to operate an economically viable service without Qantas' support (in particular, favourable access to Jetstar's domestic network).

35. We therefore expect that the most likely scenario in the event that you decline authorisation of the alliance is that the launch of American Airlines' Los Angeles-Auckland service is delayed or cancelled.
36. Eventually, it is likely that one airline (likely Qantas, American Airlines, or Delta) would independently operate a non-stop service between New Zealand and the United States, particularly if fuel prices remain low and demand continues to grow. However, this service is likely to play a more limited role in the market, as any airline operating services between New Zealand and the United States without an alliance partner would be at a competitive disadvantage compared to Air New Zealand and United Airlines.

### Conclusion

37. Overall, we consider that the proposed alliance is likely to provide significant benefits compared to the most likely alternative scenario. The key benefit is the launch of a new direct service between Auckland and Los Angeles, which would provide much needed competition against Air New Zealand and United Airlines. While the alliance does pose some risks, these are primarily speculative and likely to be outweighed by the benefits, at least in the short to medium term.

### *Term of authorisation*

38. While we are confident that the alliance will provide a net benefit to New Zealand in the short to medium term, the aviation industry is notoriously dynamic. It is possible that the alliance will not deliver the expected benefits, or that new risks will emerge. As a matter of good practice, we have taken the view that any alliance with a revenue-sharing component should be subject to a time limit.

39. As you will be aware, the Act does not provide you with the power to impose any condition or stipulation on an authorisation, including a time limit. You may only authorise (or decline) agreements as they are presented to you.

40. [redacted] Qantas and American Airlines have subsequently submitted a side-letter to the agreement confirming that it will expire five years after the date on which it is authorised. This would provide us with an opportunity to review the performance of the alliance and take account of any relevant changes in the market in five years time.

#### Measuring the success of the alliance

41. In order to determine the success of the alliance, it is important to set out how its performance will be measured. If you decide to authorise the alliance, and the applicants choose to seek reauthorisation of the alliance in 5 years time, the following factors are likely to be taken into account in our analysis:

41.1. Whether the alliance has contributed to enhanced competition for air services between New Zealand and North America. This could be demonstrated through lower fares and increased capacity (taking into account of market conditions and historical trends), or the development of new non-stop services (either by the applicants or by competing airlines including Air New Zealand and United Airlines).

41.2. Whether the alliance has delivered connectivity benefits to New Zealand. This could be demonstrated by an increase in number of passengers travelling between New Zealand and North America, and in particular, passengers travelling on services involving a connecting flight in either New Zealand or North America.

41.3. Whether the alliance has had a detrimental impact on other airlines operating services to New Zealand, or airlines that may have otherwise considered operating services to New Zealand (particularly airlines that are not party to an alliance agreement).

41.4. The extent to which the other benefits referred to in this briefing have materialised (such as premium passenger handling, joint lounge access and reciprocal frequent flyer schemes).

#### Next steps

*We recommend that you issue a media statement, announcing your decision*

42. We will separately provide your office with a draft media statement, announcing your decision to authorise the alliance. If you chose to decline authorisation of the alliance, we will work with your office to re-draft the media statement.

43. On 11 November 2015, you are scheduled to attend an event announcing the launch of American Airlines' service between Los Angeles and Auckland. As noted above, this service is likely to be dependent upon you authorising the proposed alliance.

44. Assuming you chose to authorise the alliance, we would recommend issuing the media statement during or shortly after the launch event. This would allow you to refer to the new



American Airlines service in the media statement. Our draft media statement will be prepared on this basis.

45.

*We intend to release a copy of our detailed analysis on our website*

46. Consistent with our approach to previous alliance applications, we intend to release a copy of this briefing and our detailed analysis on our website. This will provide transparency to interested parties on the decision making process and the factors that were taken into account in making your decision. We will consult with your office and with the applicants before releasing this information. Any sensitive information will be withheld in accordance with the Official Information Act 1982.

**Recommendations**

47. The recommendations are that you:

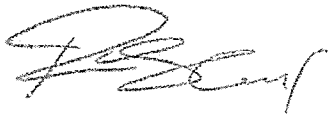
(a) **authorise** pursuant to section 88 of the Civil Aviation Act 1990, the provisions of the:

Yes/No

- i. Joint Business Agreement between American Airlines Inc and Qantas Airways Limited
- ii. Alliance Settlement Agreement between American Airlines Inc and Qantas Airways Limited
- iii. Codeshare Agreement between American Airlines Inc and Qantas Airways Limited
- iv. Alliance Agreement between American Airlines Inc and Qantas Airways Limited
- v. Amendment no.5 to the Joint Business Agreement
- vi. Side Letter to the Restated Joint Business Agreement

so far as the provisions relate, whether directly or indirectly, to the fixing of tariffs, the application of tariffs, or the fixing of capacity.

(b) **note** we will separately provide your office with a draft media statement, announcing your decision.

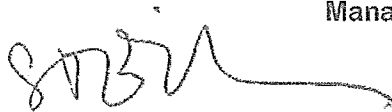


Richard Cross  
Senior Adviser



Glen-Marie Burns  
Manager Aviation & Security

MINISTER'S SIGNATURE:



DATE:

8/11/15

## **Annex A: Ministry of Transport report on the Application by Qantas and American Airlines for Reauthorisation of their Strategic Alliance**

### **Introduction**

1. Qantas Airways Limited (Qantas) and American Airlines, together the Applicants, have sought authorisation under section 88 of the Civil Aviation Act 1990 (the Act) of a proposed Restated Joint Business Agreement and associated agreements (the Agreement or Agreements).

### **Proposal**

2. Under the restated Joint Business Agreement, the airlines propose to continue to coordinate their operations on the trans-Pacific, 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 Joint Business Agreement covers coordination of operations between and within Australia/New Zealand and the United States (US), Canada and Mexico.
3. From December 2015, in partnership with Qantas, American Airlines intends to commence daily services between Sydney and Los Angeles. In conjunction with the new American Airlines services, Qantas will redeploy aircraft from its Los Angeles services and re-commence operations between Sydney and San Francisco with six services per week. Qantas has not operated to San Francisco since April 2011 and the route is currently only served by United Airlines.
4. The new capacity will result in:
  - an increase in weekly Sydney-Los Angeles services from 14 to 17;
  - six new services a week to San Francisco; and
  - a 49 percent increase in the Applicants' total joint capacity between Sydney and the west coast of the US, including a 12 percent increase in the Applicants' total joint capacity between Sydney and Los Angeles.
5. American Airlines will codeshare with Qantas and Jetstar on trans-Tasman routes.
6. The main benefit to New Zealand from the Agreement is that it provides the basis for the Applicants to expand direct services between New Zealand and the US. In June 2016, the Applicants intend to offer a new joint service between Auckland and Los Angeles, operated by American Airlines.

### Other Approvals

7. The Agreement has also been submitted to the Australian Competition and Consumer Commission (ACCC) for authorisation. The ACCC granted interim authorisation of the Agreement on 9 July 2015, and a final decision is expected by the end of November 2015.
8. In the US, the parties are also seeking approval from the US Department of Transportation (DOT).

### Current levels of cooperation

9. Qantas and American Airlines are members of the Oneworld alliance<sup>1</sup> and already cooperate on frequent flyer programs and airport lounge access.
10. The applicants are also parties to a code-share agreement. American Airlines already code-shares on 26 Qantas routes, including all Trans-Pacific Routes. Qantas code-shares on 120 American Airlines routes (including 107 US routes, eight Canadian routes and five in Latin America/Caribbean) and has access to 76 more through interline connections. Since the Original Joint Business Agreement was implemented in 2011, Qantas and American Airlines have expanded their codeshare by over 1,200 flights on over 50 city pairs servicing 40 more destinations.

### The Original Joint Business Agreement

11. On 19 May 2011, Qantas and American Airlines sought authorisation to make and give effect to a Joint Business Agreement (Original JBA) under which they would coordinate operations on services between Australia/New Zealand and the US.
12. The original Joint Business Agreement involved eight trans-Pacific routes (including Auckland-Los Angeles), 15 Australian domestic routes, three trans-Tasman routes (Auckland-Brisbane, Auckland-Sydney and Christchurch-Sydney) and more than 100 North American routes.
13. When we recommended authorisation of the Original JBA between Qantas and American Airlines, we cited the following benefits:
  - new and improved products and services including new routes, additional frequencies, improved schedules, enhanced connectivity and improved airport services, and greater choice of connections and stop-over options
  - increased tourism through increased passenger traffic and a focus on strategic joint promotion with AA Vacations<sup>2</sup> being able to draw on Qantas' Australian expertise and infrastructure

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<sup>1</sup> Global airline alliances (Star Alliance, SkyTeam and oneworld) aim to facilitate cooperation between member countries through interlining, code-sharing, reciprocal frequent flyer schemes and joint baggage handling to provide customers with a more seamless travelling experience.

<sup>2</sup> The travel agency owned by American Airlines.

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- new fare products and lower fares to more destinations through a revision of fare zones, the introduction of a 'Walkabout Pass'<sup>3</sup>, and provision for preferential availability of fares for each others passengers, ensuring more availability for discounted fares across a broader travel period
- enhanced value added services (including reciprocal lounge access, equivalent frequent flyer privileges and improved check-in procedures)
- streamlined corporate travel procurement
- providing the applicants with an incentive to offer new fare products resulting in lower fares on many trans-Pacific routes.

### **Result of the Original Joint Business Agreement**

14. The Secretary of Transport authorised the original Joint Business Agreement on 26 September 2011.
15. Not all the benefits that the applicants had sought from the Joint Business Agreement were delivered. Most notably, from 6 May 2012, Qantas ceased operating its direct service between Auckland and Los Angeles. This was due to Qantas facing large losses across its business.
16. In November 2011, AMR Corporation (the parent company of American Airlines) filed voluntary petitions for relief under Chapter 11 of the US Bankruptcy Code. This in part led to the eventual merger between American Airlines and US Airways in December 2013<sup>4</sup>.

### **Changes from the previous authorisation**

17. The applicants are looking to deepen and broaden their co-operation in a number of areas. Most significantly, and in line with recent global trends, they are looking to make the alliance metal neutral through a revenue sharing/settlement procedure. Under a metal neutral alliance, airlines seek to become indifferent as to whether a passenger travels on their aircraft (metal) or that of their partner.

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<sup>3</sup> A ticket offering multi-sector travel in Australia and New Zealand.

<sup>4</sup> American and US Airways maintain hubs in Charlotte, Chicago, Dallas/Fort Worth, Los Angeles, Miami, New York, Philadelphia, Phoenix and Washington D.C. In 2014, the airlines had approximately 197 million passengers boarding mainline and regional flights. As at December 2014, the airlines operated 983 mainline jets and were supported by regional airline subsidiaries and other third-party regional carriers, which operated an additional 566 regional aircraft. American and US Airways are members of the oneworld alliance.

## Framework for our analysis

### The Ministry's role

18. The statutory framework applying to alliance and code-share agreements between airlines is set out in Part 9 of the Civil Aviation Act 1990 (the Act). Part 9 provides an alternative mechanism to Part 4 of the Commerce Act 1986.
19. The Minister of Transport has responsibility for authorising or declining an application made under the Act. The Ministry is responsible for providing advice to the Minister on whether authorisation would be consistent with the criteria set out in the Act.
20. In some cases, decisions on alliances are made by the Secretary of Transport under delegated authority from the Minister of Transport. This typically occurs for straightforward code-share applications or alliances where the risks are deemed to be sufficiently low.

### Statutory analysis

21. Section 88 of the Act sets out a number of statutory pre-conditions, which need to be met by all provisions of the arrangements for which authorisation is being sought.
22. We have analysed the provisions of the Agreements against the statutory criteria set out in the Act and found that the Agreements do not breach the Act's criteria. A more detailed analysis is set out in Appendix 1.

### The public interest analysis

- 23.
24. We have undertaken a comprehensive analysis of the proposed Alliance to determine whether authorisation is in New Zealand's best overall interests. This consists of:
  - consideration of the counterfactual scenario (i.e. what is likely to occur if authorisation is declined)
  - consideration of the likelihood that the benefits claimed by the applicants will eventuate both with and without the Alliance
  - consideration of the likely risks or detriments that authorisation would entail for New Zealand as a whole
  - consideration of where this proposed Alliance sits alongside other code-share and alliance agreements in the New Zealand market
  - an overall conclusion drawing together the factors described above.

25. Any conclusions or assertions made in this report should be considered against our assessment of the counterfactual. The Applicants each provided confidential submissions outlining their likely course of action in the event that reauthorisation is not granted. Our view on what is likely to occur under the counterfactual is provided in paragraphs 37 to 44 of this report.

### **Conditions**

26. The ACCC can make the Agreement subject to conditions such as operating a fixed number of seats, or setting a fixed time limit on the authorisation.
27. There is no mechanism for you to impose conditions on an authorisation in New Zealand. Most alliances authorised in New Zealand have been subject to time limits, and one (between Air New Zealand and Virgin Australia in 2010) has been subject to minimum capacity requirements, but the applicants have always put these in place voluntarily.

### **Background**

#### **Revenue-share alliances are becoming more common across the airline industry**

28. International aviation is governed by a network of thousands of bilateral air services agreements. These agreements often restrict the destinations airlines are able to serve and the capacity they are able to provide. Many of these agreements also require airlines to be majority owned by nationals of their home State. This makes it difficult for airlines to merge or establish joint ventures in the same way that most other businesses can.
29. In order to overcome the restrictions imposed in bilateral air services agreements, airlines have developed means of working with one another to expand their global reach. Cooperation between airlines generally takes one of three forms:
- i. “Interline” arrangements: in which one airline agrees to sell tickets to another airline at a pre-determined price (under a “prorate” agreement”). This is the mechanism through which (for example) Qantas is able to sell its passengers a ticket from Sydney to Invercargill, even though it does not operate a service to Invercargill. Interlining arrangements are frequent throughout the aviation industry, including between members of the three ‘global alliances’<sup>5</sup> – Star, Oneworld, and Skyteam.
  - ii. “Code-share” arrangements: a more formal agreement through which an airline is effectively given the ability to sell seats on flights operated by another airline as if it were operating that flight with its own aircraft. Airlines are generally only able to enter into a code-share agreement when it has been expressly permitted in the relevant bilateral air services arrangements. Low-level code-share agreements are relatively common and rarely raise competition issues. Dozens of code-share agreements have been authorised

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<sup>5</sup> Members of global alliances work together to provide seamless services to consumers on a global level, by cooperating in areas such as scheduling, ticketing, and frequent flier schemes.

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in New Zealand. A notable example is the code-share arrangement between Air New Zealand and United Airlines (which provides Air New Zealand with access to destinations in the US beyond California).

- iii. Revenue sharing alliances: an extensive commercial agreement in which two or more airlines agree to cooperate on all aspects of pricing, scheduling and service delivery in a particular market. These arrangements are generally subject to a much higher level of regulatory scrutiny as they have the potential to reduce competition. These alliances are almost exclusively formed between airlines of the same global alliances (or airlines that are not members of any global alliance).
30. Alliances can result in benefits to consumers (for example, better access to connecting flights, and the ability to earn and redeem frequent flyer points across the networks of both airlines). However, alliances may carry significant risk as they typically result in a reduction in competition, which can lead to higher fares or reduced services.
  31. In principle, we have taken the view that alliances are a necessary tool for airlines (particularly those with small and remote home markets, such as Air New Zealand) to overcome restrictions imposed on them by bilateral air services agreements. However, each alliance agreement carries different risks and needs to be carefully scrutinised to ensure that it delivers benefits that counteract any negative impacts that may result from a reduction in competition.

### **Rationale for the Alliance**

32. The Applicants state that the Alliance will provide the basis for opportunities for the Applicants to expand the shared network to other ports on both sides of the Pacific that neither carrier currently serve, including New Zealand.
33. The Alliance offers the prospect of a new service operated by American Airlines between the US and New Zealand. Currently, Air New Zealand is the only airline operating direct services between the US mainland and New Zealand.
34. By continuing to engage in joint advertising campaigns to leverage Qantas' overseas profile and American Airlines' significant sales and marketing presence in the US, Canada and Mexico, the Applicants expect inbound tourism to Australia and New Zealand to increase further as a direct result of the alliance.
35. The Applicants suggest that this will have important spill over effects within the wider Australian and New Zealand economies, particularly by generating more employment within the tourism sector.
36. The other purported benefits of the Alliance to New Zealand are:
  - improved connectivity and increased schedule choice for travellers flying from New Zealand and Australia to destinations within the US, Canada and Mexico
  - improved products and services for customers including lounge facilities and coordinated customer service



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- enhanced benefits for members of each airlines' frequent flyer programs, particularly through reciprocal earning and redemption opportunities
- enhanced competition from rivals on the Trans-Pacific Routes.

## Counterfactual

37. A crucial part of our analysis is defining the counterfactual – in other words, the likely scenario in the event that authorisation is declined. The counterfactual effectively forms the baseline against which the costs and benefits of the Alliance should be assessed.
  38. Any conclusions or assertions made in this report from this point forward should be considered against our assessment of the counterfactual, as described below in paragraphs 39 to 44.
  39. The Applicants claim that without the Agreement, they would not have any ability to work together to grow on the Trans-Pacific Routes nor the incentive to provide each other with access to inventory on their respective domestic networks in order to maximise connectivity and customer choice.
  40. The public benefits they claim have been achieved under the Original JBA and which will be enhanced and extended by the Agreement will be significantly eroded, if not eliminated entirely, in the counterfactual scenario. Absent the alliance, the Applicants would most likely
- 
41. In particular, the incentives for the airlines to operate a direct service between New Zealand and the US would be diminished. Without the full support of the other partner, it is likely that both Qantas and American Airlines would seek to channel passengers through their existing services between Australia and North America, rather than incurring the significant costs associated with commencing a new direct service to New Zealand. The US market is heavily reliant on connecting traffic, and access to connecting services on each end of the route is vital to enable the airlines to effectively compete with Air New Zealand and United Airlines.
  42. As noted elsewhere in this report, the New Zealand–US market is uncompetitive when considered against comparable international routes. Given the current favourable operating environment, it is likely that another airline (not necessarily Qantas or American Airlines) would eventually enter the market. Other than Qantas and American Airlines, the most likely airline to operate direct services to New Zealand is Delta Airlines. However, Delta Airlines may find the New Zealand market difficult, as it would lack a partner to provide connectivity to domestic markets beyond Auckland. The two airlines providing domestic services in New Zealand (Air New Zealand and Jetstar) are already closely aligned with competing US airlines.

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43. If the Alliance is not authorised in New Zealand, but is authorised in Australia, consumers may have less access to indirect services between New Zealand and the US via the East Coast of Australia. These services provide an important competitive constraint to Air New Zealand. As a result, it is likely that Air New Zealand's fares on services to the US would increase.
44. In summary, our assessment of the counterfactual is:
- In the short to medium term (the next three years), no new airlines operate direct services to New Zealand (other than the already announced service by United Airlines). Fares between New Zealand and the US remain high in relative terms as passengers have less ability to take advantage of lower fares for indirect services via Australia.
  - In the long term (beyond three years), it is possible that another airline (either Qantas, American Airlines or Delta) will operate a direct service between New Zealand and the US, particularly if current growth rates continue. However, this service is likely to play a limited role in the market, as any airline operating services between New Zealand and the US without an Alliance partner would be at a competitive disadvantage compared to Air New Zealand and United Airlines.

## Market Definition

45. The Alliance (as it relates to New Zealand) covers routes between New Zealand and North America (the US and Canada). Currently, this is limited to indirect services via Australia. However, as noted previously, it is anticipated that the Alliance will result in the commencement of a direct service between New Zealand and Los Angeles.
46. Collectively, Qantas and American Airlines currently operate 58 services per week between Australia and the US on the following routes:
- Brisbane to Los Angeles
  - Melbourne to Los Angeles
  - Sydney to Los Angeles
  - Sydney to San Francisco
  - Sydney to Dallas
  - Sydney to Honolulu
47. Qantas will also operate seasonal services between Sydney and Vancouver three times a week (in December 2015 and in January 2016).

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48. The majority of these trans-Pacific services are scheduled to provide connectivity with Qantas' trans-Tasman network. In July 2015, the Qantas Group operated 158 return services per week between New Zealand and Australia. In January 2016, this is scheduled to increase to 177 return services per week. The Qantas Group operates trans-Tasman services to Auckland, Wellington, Christchurch and Queenstown.
49. The Alliance will also cover domestic services within New Zealand (operated by Jetstar), and American Airlines services within North America (Canada, the US and Mexico) connecting to a trans-Pacific flight. Effectively, the Alliance would provide a multitude of one and two stop flight options for passengers travelling between the following points:

Direct services	
Points in New Zealand	Points in North America
Auckland	Los Angeles

One-stop services	
Points in New Zealand	Points in North America
Auckland	Numerous points throughout North America
Wellington, Christchurch, Queenstown	Los Angeles, Dallas, San Francisco, Honolulu, Vancouver (seasonal)
Nelson, Napier, New Plymouth, Palmerston North (through Jetstar)	Los Angeles

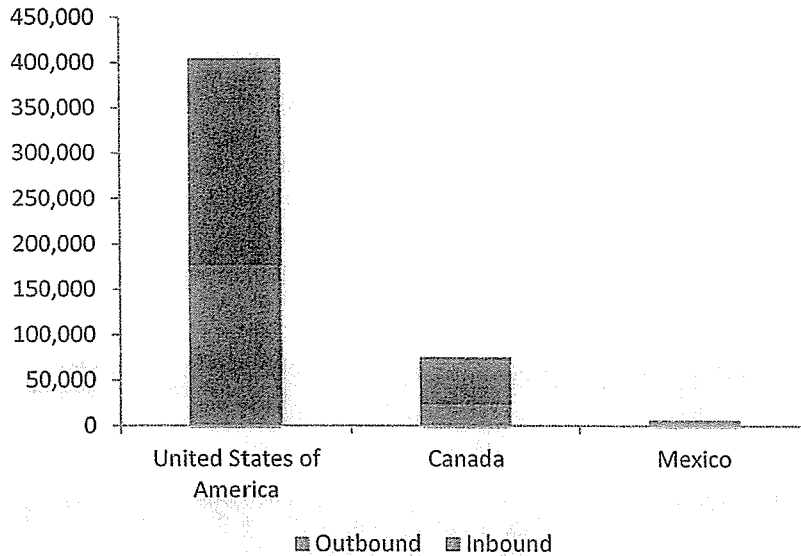
Two-stop services	
Points in New Zealand	Points in North America
Auckland, Wellington, Christchurch, Queenstown	Numerous points throughout North America
Nelson, Napier, New Plymouth, Palmerston North (through Jetstar)	Los Angeles, Dallas, San Francisco, Honolulu, Vancouver (seasonal)

50. The Alliance does not cover services beyond North America (such as Europe), or trans-Tasman services which do not connect with a flight between Australia and North America.
51. Unlike other alliances authorised in New Zealand, the proposed Alliance also covers freight services. Qantas currently operates a weekly freighter service from Chicago-Honolulu-Auckland-Sydney (in one direction only).
52. The relevant market can therefore be defined as *the market for passenger and freight transport between New Zealand and North America (Canada, the US and Mexico)*.

### Market Overview

53. In the year ended August 2015, 283,000 North American residents visited New Zealand. Around 203,000 New Zealanders listed a destination in North America (the US, Canada or Mexico) as their main destination.
54. As shown in the figure below, the majority of passengers within this market are travelling between New Zealand and the US.

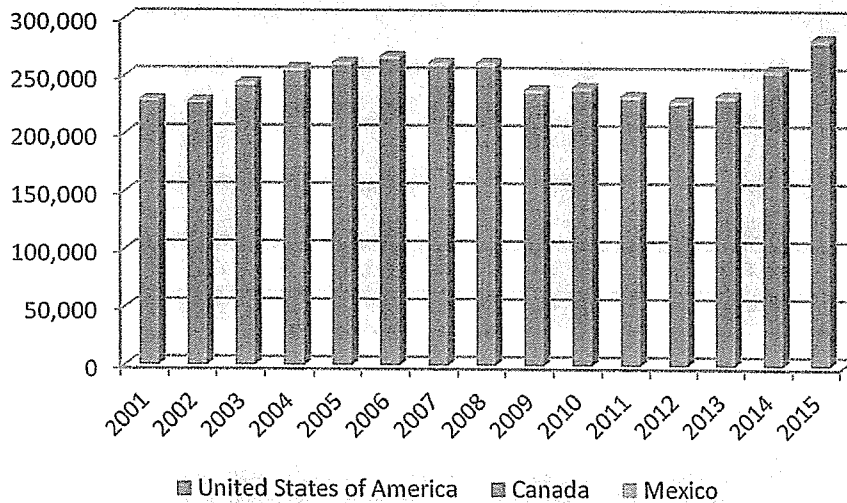
Figure 1: Passenger movements between New Zealand and North America (year ended August 2015)



55. Analysis of origin/destination data suggests that the flow of passengers is heavily influenced by the availability of direct air services. Among New Zealanders' travelling to the North America, the most common destinations are (in order) Los Angeles, Honolulu, San Francisco and Vancouver. Common destinations involving a connecting flight include New York, Toronto, Las Vegas, Chicago, and Seattle. Among North American visitors, around two thirds start their journey in either Los Angeles, Honolulu, San Francisco, Vancouver, New York or Toronto.
56. Between 2001 and 2013, North American markets showed very little growth. However, the market has shown strong growth over the past three years, which has been driven by a strong increase in the number of US visitors. In the year ended August 2015, 227,000 US residents travelled to New Zealand, surpassing the previous peak established in 2006. The Canadian and Mexican markets are also at all time highs. The recent growth has been at least in part facilitated by significant increases in capacity by Air New Zealand on the Auckland-Los Angeles and Auckland-Vancouver routes over the past 12 months.

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Figure 2: Visitor arrivals from North American markets, 2001-2015



57. The New Zealand-North America market is typically regarded as relatively uncompetitive. In terms of direct services, the market is dominated by Air New Zealand. Air New Zealand is currently the only airline operating direct (non-stop) services between New Zealand and the mainland US. However, since 2013, Hawaiian Airlines has provided direct competition on the Auckland-Honolulu route.
58. Air New Zealand currently operates services between Auckland and Los Angeles, San Francisco, Honolulu and Vancouver. From December 2015, Air New Zealand will also operate non-stop services to Houston, Texas. In October 2015, United Airlines announced that it would commence a direct service on the Auckland-San Francisco route beginning July 2016. However, this service would be operated as part of a revenue-sharing alliance with Air New Zealand. As such, it is unlikely to provide a significant competitive constraint (although any increase in capacity is likely to put downward pressure on fares).
59. As shown in the table below, there are a number of airlines offering indirect services between New Zealand and the US, including Qantas, American Airlines, United Airlines, Delta Airlines, Virgin Australia, Fiji Airways, and Air Tahiti Nui.
60. Air New Zealand's dominant market position is reflected in its market share. In the 12 months ended August 2015, Air New Zealand carried 70 percent of passengers travelling between New Zealand and North America. Air New Zealand is particularly dominant in the outbound market, where its market share is around 75 percent (compared to a 60 percent share of the inbound market). In the New Zealand-Canada market, where there are fewer indirect alternatives, Air New Zealand carries around 70 percent of inbound passengers and nearly 80 percent of the outbound passengers.

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Figure 3: Market share of North American residents travelling to New Zealand<sup>6</sup>

	United States	Canada	Mexico	Total
Air New Zealand	6			
Qantas/Jetstar	1			
Virgin Australia				
Other Airlines				
Emirates				
Fiji Airways				
Hawaiian Airlines				

Figure 4: Market share of New Zealanders travelling to North America

	United States	Canada	Mexico	Total
Air New Zealand				
Hawaiian Airlines				
Virgin Australia				
Qantas/Jetstar				
Other Airlines				
Fiji Airways				

61. In the New Zealand context, it is not unusual for a particular market to be dominated by a single airline, particularly when only one airline is operating direct (non-stop) services. Most of New Zealand's international air routes can be described as 'long and thin' routes, with relatively low demand and long flight times. Very few of these routes are large enough to support regular competition.
62. However, the Auckland-Los Angeles route in particular appears to be sufficiently large to support non-stop services by more than one airline. This is demonstrated in the following table, which compares the direct services between New Zealand and the US with those between Australia and the US. The Auckland-Los Angeles route is the largest route (in terms of weekly seats) served by a single airline. The Auckland-Los Angeles route is also considerably larger than the Auckland-Shanghai route, which is currently the only other long-haul route (with over nine hours flight time) to/from New Zealand served by more than one airline.
63. In contrast, the Auckland-Honolulu route appears to be supporting a level of competition that is at least proportionate to its size, as illustrated in the table below.

<sup>6</sup> Statistics New Zealand data only identifies the airline passengers used when arriving in or leaving New Zealand. Passengers travelling via Australia may be travelling on another airline between Australia and the United States (such as Delta, American, or United Airlines).

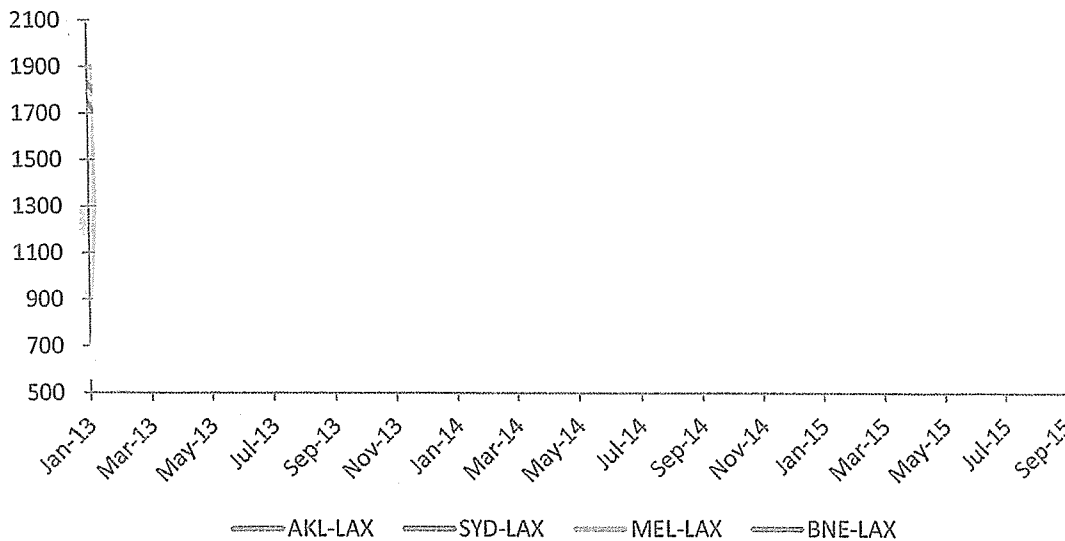
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Figure 5: Weekly seats and number of airlines operating on direct services between Australia/New Zealand and North America

	Seats per week (week of 28 September 2015)	Distance (km)	Airlines operating
Sydney-Los Angeles	12,208	12,051	4
Melbourne-Los Angeles	6,226	12,748	2
Auckland-Los Angeles	5,862	10,467	1
Sydney-Honolulu	5,836	8,154	3
Brisbane-Los Angeles	5,033	11,525	2
Sydney-Dallas	2,904	13,804	1
Auckland-San Francisco	2,296	10,487	1
Brisbane-Honolulu	2,181	7,538	2
Sydney-San Francisco	1,904	11,937	1
Sydney-Vancouver	1,890	12,484	1-2
Auckland-Honolulu	1,818	7,063	2
Auckland-Vancouver	1,216	11,335	1
Melbourne-Honolulu	1,005	8,858	1

64. Analysis of average fares suggests that despite Air New Zealand's monopoly position, fares on direct services between New Zealand and North America are broadly comparable to direct services from cities on the East Coast of Australia. As shown in the figure below, fares on the Auckland-Los Angeles route are roughly the same as fares on the Brisbane-Los Angeles route, and considerably lower than fares on the Sydney-Los Angeles and Melbourne-Los Angeles routes. However, it should be noted that the Auckland-Los Angeles route is between 10-20 percent shorter in distance than the Australian routes.

Figure 6: Average one-way fares on direct services to Los Angeles (\$US, all airlines and travel classes)

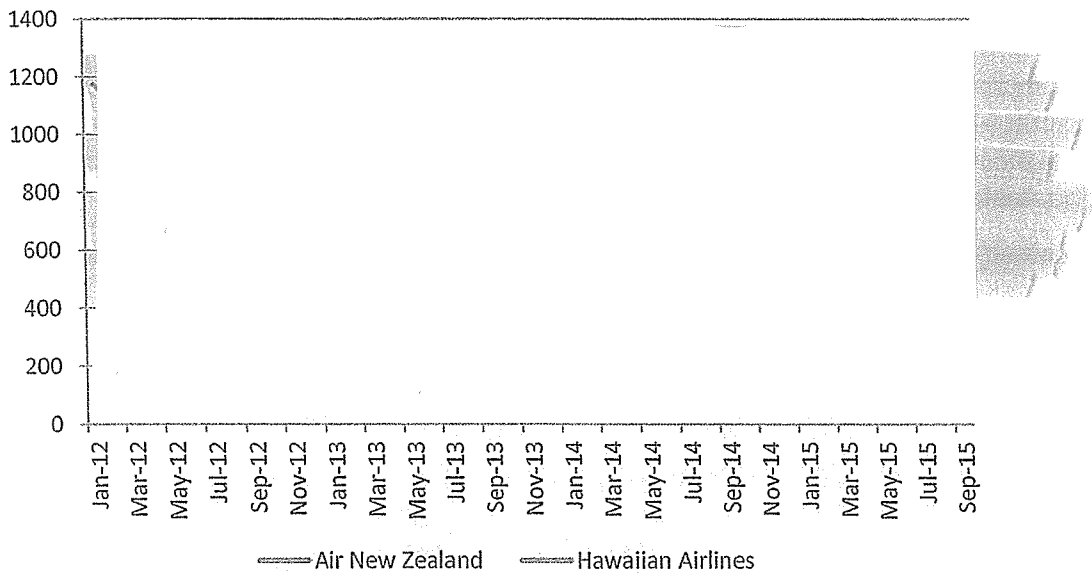


## Market Impact

### The Alliance will improve the prospects of direct competition on mainland US routes

- 65. As noted in the previous section, the market for air services between New Zealand and the US mainland (in particular, the Auckland-Los Angeles route) is generally considered to be uncompetitive.
- 66. Qantas has previously indicated that a likely outcome of the Alliance being authorised is the resumption of direct services between Auckland and the US (on the Auckland-Los Angeles route).
- 67. The resulting competition is likely to result in an increase in capacity and a reduction in fares, as Air New Zealand and American Airlines compete for market share. To estimate the likely impact, we can look at other recent examples where a new airline has entered a route that was previously dominated by a single airline. A relevant example is the recent entry by Hawaiian Airlines on the Auckland-Honolulu route. The introduction of competition resulted in a significant increase in seat capacity, as a result of both the new services by Hawaiian Airlines and a competitive response from Air New Zealand.

Figure 7: Average one-way fares between Auckland and Honolulu (\$US, all classes)





**The Alliance may have a marginal impact on existing services, compared to the counterfactual**

68. Any new air service will have an impact on existing air services to related markets. In this case, we would expect a new direct service between Auckland and Los Angeles to impact on all of the existing services between New Zealand and North America.
69. As noted previously, we believe that the Auckland-Los Angeles route is likely to be large enough to support direct competition over the long-term. The route supported head-to-head competition for over a decade until Qantas exited from the market in 2012. Since then, demand for travel between New Zealand and North America has increased.
70. A new service to Los Angeles is also likely to have an impact on existing services to Vancouver, San Francisco, Houston and Honolulu. To a large extent, these are independent markets, but there is some crossover between each of them. For example, around eight percent of passengers travelling to or from Vancouver travel on services via California, rather than on the direct Auckland-Vancouver service.

71.

72.

**Without the Alliance, indirect competition would be reduced**

73. Even without operating a direct service between New Zealand and the US, Qantas continues to provide the largest competitive constraint to Air New Zealand. As shown in figures 3 and 4 (above), Qantas carries [ ] percent of North American visitors to New Zealand, and [ ] percent of New Zealanders travelling to North America, despite the circuitous routing.
74. Qantas engages in tactical pricing in order to attract passengers from Air New Zealand. Average fares to the US via Australia are typically lower than average fares on direct (non-stop) services to the US.

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75. If the Alliance is not authorised, Qantas and American Airlines have suggested that

**Market entry by a third party is unlikely with or without the Alliance**

76. In the short term, the Alliance would result in an increase in competition between New Zealand and North America by breaking the monopoly held by Air New Zealand and United Airlines.
77. The Alliance would ensure that both airline groups (Air New Zealand/United and Qantas/American Airlines) are on equal footing, with the ability to provide passengers with onward connectivity on both ends of the route. However, there is a risk that the two alliances may effectively close the market to other competitors. There are only two domestic airlines of sufficient scale operating within the New Zealand market, so there are no obvious local partners for a third-party airline that may be considering operating services to New Zealand. It is unlikely that either Air New Zealand or Jetstar would offer competitive interline rates on domestic services to a competing airline. This does not necessarily mean that no US airlines (other than United Airlines or American Airlines) would operate to New Zealand, but it does make it less likely.
78. However, there is arguably no solution to this problem. Any alliance or code-share arrangement will create a disincentive for other airlines that are not party to the arrangement. The only way of creating a level playing field between all airlines is to decline to authorise all alliance and code-share arrangements on services between New Zealand and North America. This would seriously compromise the viability of Air New Zealand's services to the US, as it would have no means of providing a competitive product for passengers travelling to or from points in North America beyond the Houston, Los Angeles and San Francisco gateways.
79. Ultimately, we consider this issue to be a problem caused by the underlying characteristics of the New Zealand domestic market. The likelihood of three independent airlines operating services between New Zealand and the US appears to be low, regardless of whether the Alliance is authorised.

**The Alliance increases the likelihood of further direct services between New Zealand and the US being developed in the future**

80. Competition between Air New Zealand/United and Qantas/American Airlines would incentivise both airline groups to differentiate their products in order to provide a more attractive service offering and capture a greater share of the market. One way of achieving this is to develop direct services to additional destinations.

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81. While services to additional North American airports are unlikely in the short-term, the Alliance would increase the possibility of the applicants developing new services in the future. At the same time, the Alliance is likely to incentivise Air New Zealand and United Airlines to consider additional services to one or more of United Airlines' hubs (which include Chicago and Denver). Without a strong competitor, Air New Zealand and United Airlines are more likely to consolidate their operations at the airports they already serve.

**The Alliance will improve New Zealand's connectivity with North America**

82. Currently, Air New Zealand offers code-share connections on United Airlines services to 16 destinations within the US<sup>7</sup>. Code-share services to a further 15 destinations<sup>8</sup> will become available when Air New Zealand launches its Auckland-Houston service.
83. American Airlines operates from Los Angeles to a number of cities in the US that are not covered by the code-share agreement between Air New Zealand and United Airlines, including (among others) Aspen, Columbus, El Paso, St Louis, Palm Beach, Raleigh, San Diego, and Sacramento. If American Airlines launches a direct service between Auckland and Los Angeles as expected, all of these destinations would be accessible through a one-stop connecting flight.

**The Alliance is likely to lower the price of shipping goods between New Zealand and the US, but the impact is difficult to estimate**

84. A large proportion of airfreight carried between New Zealand and the US is carried in the bellyhold of passenger aircraft. In addition, Qantas operates a number of dedicated freighter services which include stops in Australia and the United States, as shown in the table below. One of these services includes a stop in Auckland.

Routing	Frequency
Sydney-Bangkok-Shanghai-Anchorage-Chicago	2x per week
Sydney-Chongqing-Shanghai-Anchorage-New York	1x per week
Sydney-Shanghai-Anchorage-New York	1x per week
Chicago-Los Angeles-Honolulu-Sydney	1x per week
Chicago-Honolulu-Auckland-Sydney	1x per week
New York-Chicago-Honolulu-Sydney	2x per week

85. Qantas' freighter services operate in one direction only (i.e., from the US to New Zealand). American Airlines does not currently provide any freighter services on Trans-Pacific Routes. Qantas and American Airlines have an interline agreement covering the carriage of freight on Trans-Pacific services in passenger aircraft, but American Airlines does not currently interline on Qantas' dedicated freighter services.

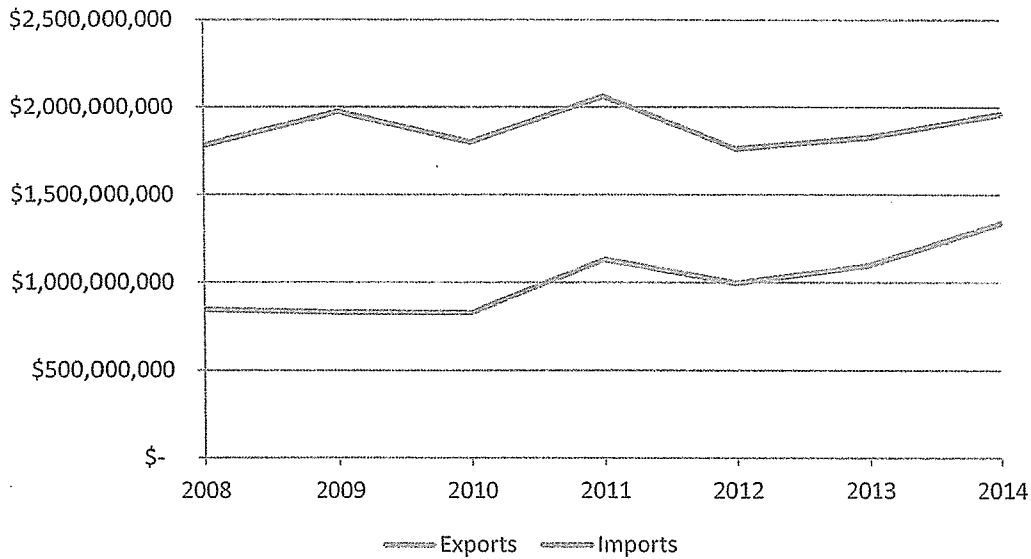
<sup>7</sup> Atlanta, Boston, Chicago, Cleveland, Dallas, Denver, Las Vegas, Newark, New Orleans, New York (JFK), Orlando, Philadelphia, Pittsburgh, Portland, Seattle, Washington.

<sup>8</sup> Albuquerque, Austin, Charlotte, Detroit, Fort Lauderdale, Indianapolis, Miami, Minneapolis, Nashville, New York (La Guardia), Oklahoma City, Omaha, Phoenix, Salt Lake City, Tampa.

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86. There is usually more airfreight into New Zealand than out of New Zealand. By value, 26 percent of New Zealand’s exports to the US and 33 percent of its imports from the US are carried by air.

Figure 8: Imports and Exports by air between New Zealand and the US



- 87. The applicants indicate that Qantas has a share of 7 percent of freight traffic from the US to New Zealand and a share of 2 percent of freight traffic from New Zealand to the US.
- 88. Although it does not operate any dedicated freighter services, Air New Zealand has the largest share of the New Zealand-US air freight market. In 2014 (January-November), Air New Zealand carried approximately 90 percent of all freight and mail between New Zealand and the US, all in the bellyhold of passenger aircraft.
- 89. Other airlines operating in the New Zealand–US freight market include Hawaiian Airlines and China Airlines, which signed a codeshare agreement in 2013 connecting New Zealand to Honolulu via Brisbane and Sydney. FedEx also operates a weekly freighter service between the US and New Zealand.
- 90. The impact of the Alliance on freight markets is likely to broadly mirror its impact on passenger markets. Exporters and importers are likely to benefit from the new American Airlines service between Los Angeles and Auckland, which will provide an alternative option for shipping time-sensitive goods. As noted previously, this additional capacity is unlikely to eventuate in the counterfactual.
- 91. We do not have access to data on the extent to which existing freight capacity is being utilised, so it is difficult to estimate the extent of any price reductions. However, it is reasonable to assume that the additional capacity will result in lower rates for shipping goods by air.

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92. Overall, the impact on freight markets is likely to be less significant than the impact on passenger markets, as the majority of exporters are unlikely to be concerned if their goods travel on indirect services via Australia or Asia. It is likely that these indirect services are already placing a constraint on the rates charged for the carriage of freight on direct services, particularly for goods produced in the South Island, where there are no non-stop services to the US.

## Other benefits

### Benefits for Frequent Flyers and Premium Customers

93. The applicants claim that the Alliance will enhance the benefits for members of both parties' frequent flyer programs. Over the course of the Original JBA, the Applicants have implemented reciprocal privileges for each other's frequent flyers when travelling on the other airline. The carriers now offer what are effectively full reciprocal, earn-and-burn programs on all domestic and international flights. This is of direct benefit to the over [redacted] Qantas Frequent Flyers resident in New Zealand.
94. If the Alliance is authorised, Qantas and American Airlines customers will continue to be offered a range of services including:
- reciprocal lounge access
  - priority check-in/boarding and baggage handling for premium customers
  - joint access to airline lounges.
95. We agree that there will be benefits to some consumers through frequent flyer benefits, enhanced customer services such as lounge access and additional premium services. However, as with previous alliance applications, we have not placed significant weight on these benefits. We also note that many of these benefits would be likely to occur even if the Alliance is declined, assuming the applicants continue to cooperate through a more limited code-share arrangement.

### Increased Tourism

96. The Applicants claim that their original Joint Business Agreement has successfully stimulated inbound tourism to the Australasian region through coordinated joint marketing campaigns.
97. The benefits of the existing Joint Business Agreement on the New Zealand tourism industry are likely to be small, given that neither airline currently operates a direct service between New Zealand and North America. The applicants note that they have conducted a number of joint marketing campaigns, but to date these campaigns have been largely focussed on building demand for travel between the US and Australia.
98. Currently, around [redacted] passengers per year travel to New Zealand on code-share tickets booked through American Airlines. The commencement of the Sydney-Dallas service in particular is likely to have had a marginal impact on New Zealand tourism by opening up a new one-stop connection between Texas and New Zealand. Around

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passengers travelling between Dallas and New Zealand used this service in the year ended September 2015.

99. The proposed direct service between Los Angeles and Auckland, which would be enabled by the proposed Alliance, is likely to result in significant tourism benefits to the New Zealand economy. As discussed previously, we would expect this service to result in additional capacity and lower fares, which would in turn stimulate additional demand for travel between New Zealand and North America.
100. New Zealand will also become far more visible as a destination to American Airlines frequent flyer members looking to spend their airpoints.

### **Cost savings and economic efficiencies**

101. The Applicants claim that they will continue to operate cost effective and efficient networks by coordinating their activities and operations.
102. A significant change under the Agreement will be the achievement of 'metal-neutral' selling of the applicant's joint services (clause 2.1 of Annexure B of the Application). The Applicants will align their economic incentives and organise their sales functions to enable them to be indifferent as to which joint service the customer chooses.
103. This provides the incentive for the Applicants to allow each other access to the full inventory of available seats, and to prioritise such access on the basis of whether the customer is seeking to book a long haul Trans-Pacific journey, using either or both carriers (as opposed to reserving inventory for domestic passengers on the Applicants' respective home networks).
104. In the New Zealand context, the 'metal neutrality' provision would ensure that Qantas has strong incentives to sell and market American Airlines' service between Auckland and Los Angeles. The viability of this service over the long term would be significantly enhanced with two airlines invested in its success (including an airline with a strong presence in the New Zealand market).

### **Submissions**

105. We received submissions on the Agreement from Auckland Airport, Tourism New Zealand, Christchurch Airport, and the Tourism Industry Association of New Zealand.
106. The submitters all generally supported the application, citing the overall public benefits to New Zealand of greater choice and improved tourism from US travellers to New Zealand destinations (through Jetstar's services). Submitters noted that these benefits would be even larger if American Airlines offered a new service from the US to New Zealand. All submitters noted that the US is one of New Zealand's largest tourism markets in terms of both the number of visitors and their average spend in New Zealand.
107. The Tourism Association of New Zealand elaborated on Jetstar's decision to start flights to at least four New Zealand regional destinations in 2015. The Alliance

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provides an opportunity to disperse passengers to a greater range of New Zealand using Jetstar's enhanced domestic network.

108. Christchurch Airport raised concerns over the lack of examples of how the Applicants intend to increase marketing of Christchurch and other South Island destinations to US, Canadian and Mexican travellers (as well as for freight).

## Appendix 1: Statutory Analysis

109. This section examines whether and how the Alliance Agreement complies with Part 9 (principally section 88(4)) of the Civil Aviation Act 1990.

### Section 88(3):

*In considering whether to grant authorisation under subsection (2) of this section, 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.*

110. New Zealand has open skies agreements with both the US (the Multilateral Agreement on the Liberalisation of International Air Transportation (MALIAT) under which American Airlines operates) and Australia (under which Qantas is designated and qualifies as 'Single Aviation Market' airline). Both of those agreements provide for open routes and capacity and explicitly provide for third country code-sharing.

111. Authorisation of the arrangements is thus consistent with the relevant arrangements and would not prejudice compliance with them.

### Section 88(4):

*Subject to subsection (5) of this section, authorisation shall not be given under this section to any provision of any contract, arrangement, or understanding that:*

(a) *“provides that any party to it may directly or indirectly enforce it through any form of action by way of fines or market pressures against any person, whether or not that person is a party to the contract, arrangement, or understanding”*

112. The Agreements do not contain any provisions that provide for enforcement through fines or market pressures.

(b) *Has the purpose or effect of breaching the terms of a commission regime issued under section 89 of this Act*

113. Two commission regimes issued by the Minister of Transport are currently in force - the Civil Aviation (Passenger Agents' Commission Regime) Notice 1983 and the Civil Aviation (Cargo Agents' Commission Regime) Notice 1983.

114. The Agreements have several references to commissions paid to travel agents in particular in relation to sales and marketing and revenue calculations.

115. These provisions do not have the purpose or effect of breaching the terms of either of these commission regimes. There is no prohibition on offering commissions outside the scope of a commission regime.

(c) *Unjustifiably discriminates between consumers of international air services in the access they have to competitive tariffs*

116. The Joint Business Agreement does not set tariffs itself but rather sets out that the parties may coordinate activities on pricing. Therefore the Joint Business Agreement itself not contain any provisions that unjustifiably discriminate between consumers of international air services in the access they have to competitive tariffs.



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117. Prices in a market will be influenced by a number of supply and demand factors which are addressed elsewhere in this report.
- (d) 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 it relates**
118. The Alliance Agreement provides that \_\_\_\_\_
- \_\_\_\_\_
119. Such clauses are common in revenue sharing alliances.
120. The agreements do not however prohibit interlining arrangements with other airlines so do not have the effect of excluding other suppliers of international carriage by air from participating in the market to which it relates.
- (e) Has the purpose or effect of preventing any party from seeking approval, in terms of section 90 of this Act, for the purpose of selling international carriage by air at any other tariff so approved**
121. Neither the MALIAT nor the New Zealand – Australia Air Services Agreement require the filing of tariffs. As a matter of regulatory/administrative practice we have not in any case required airlines to seek approval of tariffs for more than twenty years.
122. The Agreement contains a number of provisions relating to cooperation in the setting of tariffs.
123. These provisions do not however prevent either party for seeking authorisation of any other tariff should they wish to do so.
- (f) Prevents any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding**
124. The Joint Business Agreement and the Codeshare Agreement have an initial term of ten years but either party may give notice to withdraw after three years with two schedule periods (12 months) notice. This effective term of four years is reasonable given the extent to which the airlines will be making commitments based on the agreement and is in line with other revenue sharing alliances that have been authorised recently.
125. There are also a number of circumstances (such as material default, force majeure or insolvency) under which one party may terminate the agreement with shorter notice and within the first three years.
126. The Alliance Agreement and the Alliance Settlement Agreement will terminate on termination of the Joint Business Agreement.

*Conclusion on section 88(4)*

127. None of the provisions of any of the agreements for which authorisation is sought breach any of the terms of section 88(4) of the Act.

**Section 88(5):**

***Notwithstanding the provisions of subsection (4) of this section, the Minister may authorise any provision of any contract, arrangement, or understanding under this section if the Minister believes that to decline authorisation would have an undesirable effect on international comity between New Zealand and any other State.***

128. This provision only becomes relevant if, contrary to the advice set out above, you determine that provisions in the agreements fall foul of one of the criteria in section 88(4) of the Act.
129. Comity is not defined in the Act and the Act is the only instance of the use of the term in New Zealand legislation.
130. "Comity" is defined in the Shorter Oxford (in the form of "comity of nations") as being "the courteous and friendly understanding by which each nation respects the laws and usages of every other, so far as may be without prejudice to its own rights and interests. Legal dictionaries focus more on the aspect of courts taking due notice of foreign laws and judgments. Comity is not part of international law but is regarded as important for public policy reasons.
131. Most international code-share arrangements will require approval in two (in this case three) jurisdictions, each with their own legislation or processes. This provision should not be interpreted to mean that New Zealand must always accept and adopt the findings of the other regulator. The different regulators will be applying different legislation. The impacts of a proposed Alliance may also be different in the two countries.
132. The ACCC has for example, in the case of Air New Zealand and Air Canada, declined authorisation to arrangements that had been authorised in New Zealand. Both Australia and the US have a framework of independent decision making in this area.
133. We do not consider that declining to authorise any provisions of the Agreements would have an undesirable effect on international comity between New Zealand and any other State.

**Section 90:**

***Authorisation of tariffs by Minister***

- (1) The Minister may from time to time specially authorise any tariff in respect of international carriage by air where the relevant places of departure and destination are within the territories of 2 countries, one of which is New Zealand, whether or not there is to be a break in the carriage or a transshipment.***
- (2) In giving authorisation under this section the Minister shall have regard to -***
  - (a) Whether the proposed tariff is excessive in terms of a reasonable return on investment by the supplier of the carriage; and***
  - (b) Whether it is likely that supply of the relevant carriage can be carried on for a reasonable period at the level of tariff proposed; and***

***(c) Whether there is likely to be a substantial degree of benefit accruing to consumers generally, or to a significant group of consumers, as a result of the application of the proposed tariff,-***

***and shall ensure that the granting of such authorisation will not prejudice compliance with any international convention, agreement, or arrangement to which the Government of New Zealand is a party.***

134. We have previously sought advice from Crown Law about the interplay of sections 88 and 90 of the Act.

135. As set out in the discussion of subsection 88(4)(e) above, the Agreements provide that the parties may individually seek authorisation pursuant to section 90. The criteria in section 90(2) relate to individual tariffs and would be considered in the context of any such application received. The fact that many of the tariffs under the Agreements will be set by the Alliance parties together should not frustrate an assessment of an individual tariff if the situation arises.

136. The provisions of section 90 will be relevant in the event that approval is sought for an individual tariff by one of the applicants, but do not preclude authorisation of any provision in the Agreements.

Appendix 2: Clause-by-clause analysis of the Agreements against section 88 (2) of the Act

Joint Business Agreement

		Structural/Machinery
	Introduction	Structural/Machinery. Some clauses relate directly or indirectly to the fixing of tariffs or capacity
	Recitals	Structural/Machinery
1	Definitions and Effectiveness	Relates directly or indirectly to the fixing of capacity and the fixing and application of tariffs
2	Structure and scope of the joint business	
3	Operation of the Joint Business	
3.1	Schedule co-ordination	Directly relates to the fixing of capacity
3.2	Capacity management	Directly relates to the fixing of capacity
3.3	Revenue Planning	Indirectly relates to the fixing of tariffs and capacity
3.4	Passenger Processing	Machinery. Sets out provisions necessary for the operation of other provisions relating to tariffs and capacity
3.5	Oneworld Alliance Agreements	Machinery. Sets out how this agreement relates to other agreement. Indirectly relates to the fixing of tariffs and capacity
3.6	Quality Control	Indirectly relates to the fixing of capacity
3.7	Cost synergies	Mostly do not relate to the fixing of capacity or tariffs. Elements relating to frequent flyer programmes and lounges relate indirectly to the fixing of tariffs
3.8	Charter Flights	Relates to the fixing of capacity
4	Governance	Machinery. Sets out provisions necessary for the operation of other provisions relating to tariffs and capacity
5	Sales and Marketing	Directly and indirectly relates to the fixing of tariffs and capacity
6	Frequent Flyer Programs	Indirectly relates to the fixing and application of tariffs
7	Term and Termination	Machinery. In entering into agreements about tariffs and in particular capacity, parties need to understand how these arrangements can be wound up and what will happen if they are wound up
8	Regulatory Filings	Machinery. Sets out the parties obligations about achieving regulatory

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		approval for elements of agreements that inter alia relate to the fixing of tariffs and capacity
9	Confidentiality	Boilerplate
10	Notices	Boilerplate
11	Governing Law and Arbitration	Boilerplate
12	Consequential damages	Boilerplate
13	Data Protection and Privacy	Boilerplate
14	Affiliates	Machinery – relates to the role of affiliates in agreements which relate inter alia to the fixing of tariffs and capacity
15	Compliance with Laws and Regulations	Boilerplate
16	Amendment; waiver	Boilerplate
17	Assignment	Boilerplate/machinery
18	Independent contractor	Boilerplate/machinery
19	Third parties	Boilerplate/machinery
20	Force Majeure	Boilerplate
21	Further Assurances	Boilerplate
22	Counterparts	Boilerplate
23	Headings; construction	Machinery
24	Severability	Boilerplate
25	Entire Agreement	Boilerplate
	Execution	Machinery
App A	Definitions	Machinery

Codeshare Agreement

	Introduction	Structural
	Recitals	Structural/Machinery
1	Definitions	Machinery
2	Code-share Service	Indirectly relates to the fixing of capacity
3	Implementation and Expenses	Machinery. Necessary for the implementation of arrangements relating to the fixing of capacity

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4	Inventory Control and Procedures	Indirectly relates to the fixing of capacity
5	Marketing and Product Display	Machinery. Necessary for the implementation of arrangements relating to the fixing of capacity
6	Traffic Document Issuance and Financial Settlement	Machinery . Necessary for the implementation of arrangements relating to the fixing of capacity
7	Facilities	Machinery. Necessary for the implementation of arrangements relating to the fixing of capacity
8	Training	Machinery. Necessary for the implementation of arrangements relating to the fixing of capacity
9	Security	Machinery. Necessary for the implementation of arrangements relating to the fixing of capacity
10	Safety and Maintenance	Machinery. Necessary for the implementation of arrangements relating to the fixing of capacity
11	Free and Reduced Rate Transportation	Relates to the fixing of tariffs
12	Other Marketing Programs	Relates to the fixing or application of tariffs
13	Trademarks and Corporate Identification	Machinery (partly boilerplate)
14	Representations and Warranties	Boilerplate
15	Government Approvals	Machinery
16	Term	Machinery – in entering into agreements about tariffs and in particular capacity, parties need to understand how these arrangements can be wound up and what will happen if they are wound up – indirectly relates to the fixing of tariffs and capacity
17	Machinery	Machinery – necessary for the implementation of arrangements relating to the fixing of capacity
18	Insurance	Machinery – necessary for the implementation of arrangements relating to the fixing of capacity
19	Taxes	Machinery – necessary for the implementation of arrangements relating to the fixing of capacity
20	-	
21	Force Majeure	Boilerplate
22	Governing Law and Arbitration	Boilerplate
23	Covenant to comply with all laws	Boilerplate

24	Publicity	Machinery – necessary for the implementation of arrangements relating to the fixing of capacity
25	Confidentiality	Boilerplate
26	Assignment	Boilerplate
27	Severability	Boilerplate
28	Exclusivity	Machinery – necessary for the implementation of arrangements relating to the fixing of capacity
29	Further assurances	Boilerplate
30	Miscellaneous	Boilerplate
31	Privacy	Boilerplate
32	Notices	Boilerplate
	Execution	Structural/Machinery
Annex A	Definitions	Structural/Machinery
Annex B	Codeshare routes	Relates to the fixing of capacity
Annex C	Financial Settlement	Indirectly relates to the fixing of tariffs

Alliance Agreement

	Recitals	Structural/Machinery
1	Scope of the Alliance	Most provisions relate directly and indirectly to the fixing of tariffs and capacity. Provisions on joint procurement do not relate to the fixing of tariffs and capacity
2	Term	Machinery
3	Exclusivity	Machinery. Sets out when the parties can, and when the parties cannot enter into agreements relating to the fixing of tariffs or capacity with third parties, therefore indirectly relates to the fixing of tariffs and capacity
4	Notices	Boilerplate
5	Governing Law and Arbitration	Boilerplate
6	Representation and Warranties	Boilerplate
7	Termination Rights	Machinery
8	Relationship to Other Agreements	Machinery

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9	Effect of Termination	Machinery
10	Consequential Damages	Boilerplate
11	Data Protection and Privacy	Boilerplate
12	Affiliates	Machinery – relates to the role of affiliates in agreements which relate inter alia to the fixing of tariffs and capacity
13	Compliance with Laws and Regulations	Boilerplate
14	Amendment: Waiver	Machinery/Boilerplate
15	Assignment	Machinery/Boilerplate
16	Independent Contractor	Boilerplate
17	Third parties	Boilerplate
18	Force Majeure	Boilerplate
19	Further Assurances	Boilerplate
20	Counterparts	Boilerplate
21	Headings: Construction	Structural
22	Severability	Boilerplate
23	Entire Agreement	Machinery/Boilerplate
24	Costs and Expenses	Boilerplate
	Execution Page	Machinery
	Definitions	Machinery
Sched 1		



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Alliance Settlement Agreement

Recitals	Recitals	Structural/Machinery
1	Definitions, Effectiveness and Supremacy	Structural/Machinery
2	Alliance Settlement	2.1 Indirectly relates to the fixing of tariffs and capacity 2.2 Machinery
3	Certain other payments	Indirectly relates to the fixing of tariffs and capacity
4	Monthly and Annual Procedures for the Calculation and audit of Alliance Settlement	Machinery. Necessary for the operation of other provisions relating to tariffs and capacity
5	Taxes	Machinery. Necessary for the operation of other provisions relating to tariffs and capacity
6	Term and Termination	Machinery – in entering into agreements about tariffs and in particular capacity, parties need to understand how these arrangements can be wound up and what will happen if they are wound up – indirectly relates to the fixing of tariffs and capacity
7	Confidentiality	Boilerplate
8	Notices	Boilerplate
9	Governing Law and Arbitration	Boilerplate
10	Consequential Damages	Boilerplate
11	Data Protection and Privacy	Boilerplate
12	Compliance with laws and regulation	Boilerplate
13	Amendment; Waiver	Boilerplate
14	Assignment	Boilerplate
15	Independent contractor	Boilerplate
16	Third Parties	Boilerplate
17	Force Majeure	Boilerplate
18	Further Assurances	Boilerplate
19	Counterparts	Boilerplate
20	Headings; construction	Structural
21	Severability	Boilerplate
22	Entire Agreement	Boilerplate
	Execution	Machinery

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A1	Definitions	Machinery
A2	Accounting Principles	Indirectly relates to the fixing of tariffs and capacity
A3	Equivalent Seat Calculations for LAX-JFK and SYD-DFW	Indirectly relates to the fixing of capacity

Amendment No. 5 to the Joint Business Agreement

	Introduction	Structural
	Recitals	Structural/Machinery
1	Definitions and Effectiveness	Machinery
2	JB Flights	Relates directly and indirectly to the fixing of capacity
3	Revised Annex 1	Structural
4	Termination	Machinery
5	No Other Amendments	Machinery
	Execution Page	Machinery
A1	JB Routes	Relates directly and indirectly to the fixing of capacity

Key

Structural: Document framework. Not related to tariffs and/or capacity

Machinery: Makes *this* agreement work. May be:

- directly related to tariffs and/or capacity
- indirectly related to tariffs and/or capacity
- not related to tariffs and/or capacity

Boilerplate: Standard provisions of a general nature not peculiar to *this* agreement. Not related to tariffs and/or capacity