

Application by Air New Zealand and Air China for authorisation of a Strategic Alliance

Detailed analysis

Ministry of Transport

10/7/2015

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Purpose

1. This report provides a detailed summary of the Ministry of Transport's (the Ministry's) analysis of the application by Air New Zealand and Air China (together the applicants) for authorisation of a Strategic Alliance Agreement (the alliance).
2. The application has been made under Part 9 of the Civil Aviation Act (the Act) which provides an alternative framework for alliance and code-share agreements to Part 2 of the Commerce Act 1986. The Minister of Transport is responsible 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.

Scope of the alliance

Intended scope of the alliance

3. Under the alliance, the applicants would coordinate their operations between and within New Zealand and China.
4. The applicants would share their revenue, code-share¹ and coordinate capacity and pricing on direct services between New Zealand and China. This includes Air New Zealand's current daily Auckland-Shanghai service and a proposed new daily service by Air China between Auckland and Beijing.
5. The applicants would code-share and coordinate pricing, but not share revenue, on domestic services in New Zealand and China that connect to an international service between both countries.

Current level of cooperation

6. Air New Zealand and Air China are members of the Star Alliance² and already cooperate on frequent flyer programs and airport lounge access.
7. The applicants are also parties to a code-share agreement under which:
 - Air China code-shares on Air New Zealand's Auckland-Shanghai service and seven trans-Tasman services.
 - Air New Zealand code-shares on four of Air China's Australia-China services and three domestic services within China.

¹ Code-sharing allows airlines to sell seats on each other's flights and agree on how schedules and fares are set.

² 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.

Framework for our analysis

Statutory analysis

8. The applicants have applied for authorisation pursuant to section 88 of the Act. The Act provides for an exemption from the Commerce Act 1986 for cooperative arrangements between international airlines.
9. 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.
10. We have analysed the provisions of the alliance 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 the Appendix.

Public interest analysis

11.

In making your decision, you may weigh any detriment to consumer welfare against any special considerations relating to international air carriage in the relevant markets.

12. 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.
13. 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 45 to 58 of this report.

14. Benefits accruing to Air New Zealand rather than a foreign entity are considered benefits to New Zealand. Where relevant, we also take account of the impact that authorising or declining an agreement may have on New Zealand's aviation industry and our international connectivity over the long term – both of which are indirectly affected by Air New Zealand's success as a business. However, the fact that the New Zealand government owns 53 percent of Air New Zealand is not a consideration in our analysis.

Background

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

15. International aviation is governed by a network of thousands of bilateral air services agreements. These agreements 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.
16. 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 Nelson, even though it does not operate a service to Nelson. Interlining arrangements are frequent throughout the aviation industry, including between members of the three 'global alliances'³ – Star, Oneworld, and Skyteam.

³ 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.

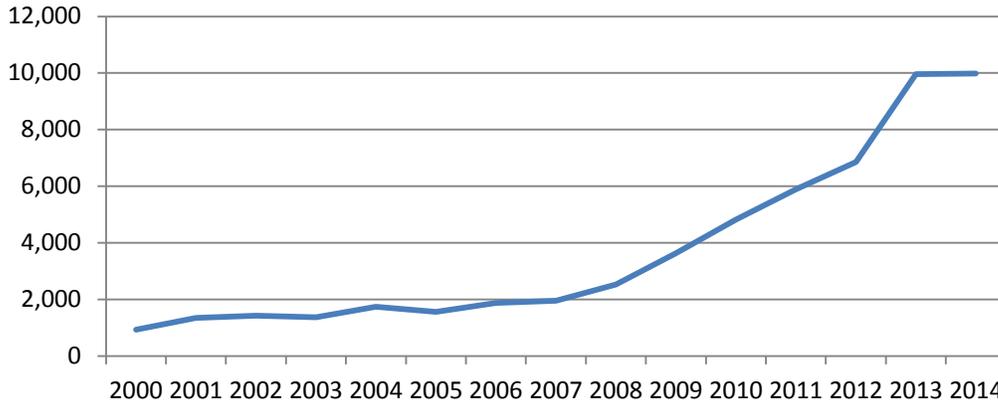
- ii. “Code-share” arrangements: a more formal agreement through which an airline is effectively given the ability to sell seats on flights operated by another airline as if it were operating that flight with its own aircraft. Airlines are generally only able to enter into a code-share agreement when 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 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 United States 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 significantly 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).
17. 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 if they result in a reduction in competition, which can lead to higher fares or reduced services.
18. 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.⁴ 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.

Trade and tourism from China is strategically important for New Zealand

19. China has fast become one of New Zealand’s largest sources of trade and tourism. Notably, China has surpassed Australia as New Zealand’s number one export destination for goods and services.
20. Exports to China have grown tenfold since 2000 as shown in the following graph. In 2014 annual goods exports to China were worth almost \$10 billion.

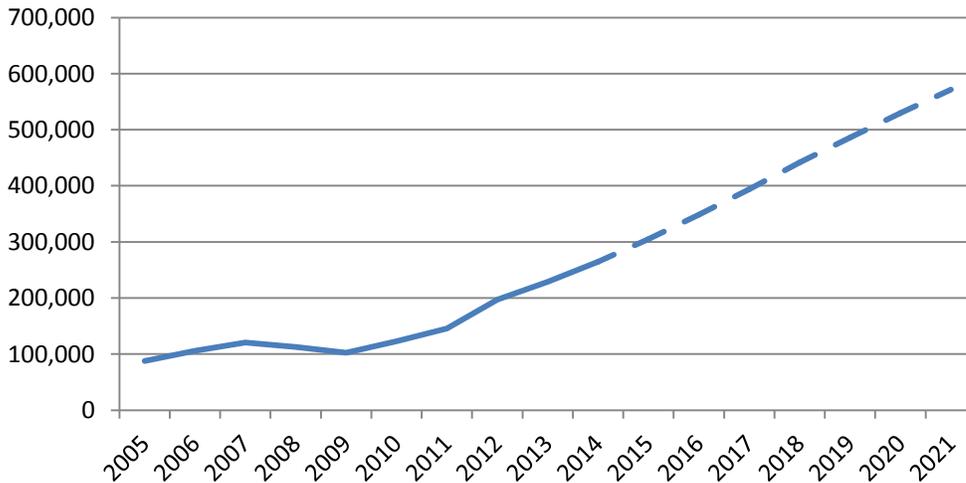
⁴ Many bilateral air services agreements in effect require airlines to be majority owned by nationals of their home State. This makes it difficult for airlines to merge or establish joint ventures in the same way that most other businesses can.

Figure 1 – New Zealand exports to China (\$millions)



21. China is our second largest tourist market, behind Australia. Visitor arrivals for the 12 months ending April 2015 totalled just over 300,000. Chinese visitors spend on average \$4,100 per visit which totals to around \$1 billion per annum⁵. The latest forecasts released by the Ministry of Business, Innovation and Employment suggest that arrivals from China are likely to double over the next five years (see Figure 2 below).

Figure 2 – Chinese visitor arrivals including forecasts to 2021⁶



22. The economic relationship with China is clearly one that holds significant value and promise for New Zealand.

⁵ Data from Statistics New Zealand and Ministry of Business, Innovation and Employment.

⁶ Data taken from New Zealand Tourism Forecasts available at http://www.med.govt.nz/sectors-industries/tourism/tourism-research-data/forecasts/pdf-library/tourism_forecasts_2015-2021.pdf.

23. China also places significant value on the relationship, attributing “four firsts” to New Zealand:
- i. In 1997 New Zealand became the first country to agree to China’s accession to the World Trade Organization by concluding the bilateral negotiations component of that process.
 - ii. New Zealand was the first developed country to recognise China as a market economy.
 - iii. New Zealand was the first developed country to commence Free Trade Agreement negotiations with China. In November 2004, New Zealand and China launched Free Trade Agreement negotiations.
 - iv. In April 2008, New Zealand became the first country to successfully conclude Free Trade Agreement negotiations with China.
24. Some commentators have positioned New Zealand’s membership of the Asian Infrastructure Investment Bank as a fifth first (New Zealand was the first developed country to join) and as something that will further strengthen ties between the two countries.
25. The applicants formalised their intention to enter into an alliance in November 2014 during a State Visit to New Zealand by President Xi of China. The Prime Minister (Right Honourable John Key) and President Xi were present during the announcement and the applicants’ statement of intent on the alliance was included in the official list of announceables and deliverables from that visit.
26. The manner in which China sees the relationship between commercial arrangements such as these and the wider government relationship can be seen in Australia. An alliance between China Eastern and Qantas was similarly announced during a State Visit in Australia. The Chinese Ambassador to Australia has submitted to the Australian Competition and Consumer Commission (ACCC). In his letter the Ambassador noted that he considered the arrangements to be in the long term interests of both Australia and China and expressed his hope that the ACCC could bear in the mind the interests of the overall relationship and make a fair and reasonable decision. We could expect the Chinese government to take a similar position with regards to this alliance.

Rationale for the alliance

The alliance gives Air New Zealand a stronger foothold in the China market

27.

the recent commencement of China Eastern's Auckland–Shanghai service, which operated up to daily over the 2014/15 New Zealand summer and will operate four times weekly on a year round basis from September 2015.

28.

the market is heavily skewed towards inbound passengers, who are generally inclined to fly on a Chinese carrier.

29. Having a strong home carrier in China supporting Air New Zealand's Auckland – Shanghai service would

- i. providing access to Air China's distribution and sales strength in China
- ii. combining both carriers networks allowing more connecting options for markets beyond Auckland, Shanghai and Beijing.

30.

it is expected that the code-share agreement will allow Air New Zealand to code-share on some additional Air China domestic services.

31. Air New Zealand intends for its alliance with Air China to operate in parallel with its alliances with Cathay Pacific and Singapore Airlines.

The alliance provides Air China with a low risk means of commencing direct services to New Zealand

32. The Alliance provides Air China with an opportunity to enter the New Zealand market, as part of an alliance with Air New Zealand that mitigates many of the risks associated with commencing a new service.

34. The Alliance will also allow Air China to provide its customers with a Shanghai-Auckland service, without undertaking the substantial risks associated with entry onto a competitive route where two airlines are operating non-stop and several others provide one-stop services.

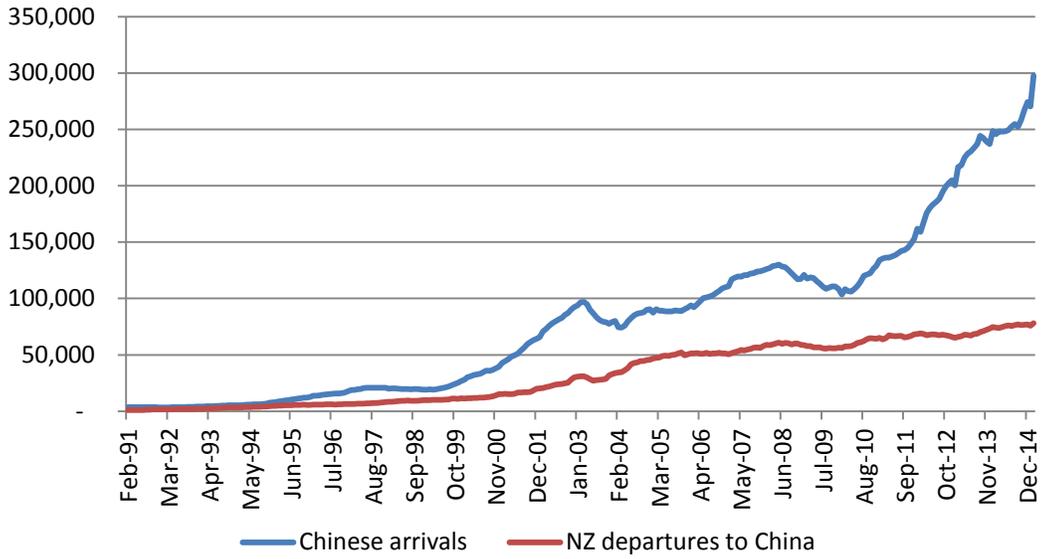
Market definition

36. The alliance is much narrower in scope than other alliances that have previously been authorised, such as the Qantas/Emirates and Air New Zealand/Singapore Airlines alliances.
37. During the 12 month period ended February 2015, around percent of passengers on Air New Zealand's services between Auckland and Shanghai were travelling directly between New Zealand and China. A
38. The main markets of focus for the alliance are Shanghai (population of approximately 24 million people) and Beijing (population of approximately 22 million people) and the passengers travelling directly between New Zealand and each of these cities.

Much of our analysis focuses on inbound traffic

39. These markets are predominantly inbound markets. New Zealand residents make up a relatively small and declining proportion of passengers who travel between New Zealand and China (22 percent of 2014 traffic). Figure 3 below shows how inbound traffic has grown at a much faster rate compared to outbound traffic.
-

Figure 3 – Market for travel between New Zealand and China (cumulative 12 month total)



40.

the figure below suggests that outbound demand fluctuates and is relatively unresponsive to changes in supply.

Figure 4 – Change in market shares for airlines compared to changes in demand for travel by New Zealand residents to China (data for year ended February)

41. The data seems to suggest that New Zealand travellers are indifferent to which airline they fly on, likely choosing carriers based on demand side variables such as prices and frequencies. Outbound demand has also been relatively unresponsive to changes in capacity, . This is further evidence of the need to leverage demand for travel by Chinese residents to viably commence new or expanded services between New Zealand and China.
42. Due to the size and growth of the inbound traffic in these markets, much of our analysis is focused on traffic from China, in particular from Beijing and Shanghai.

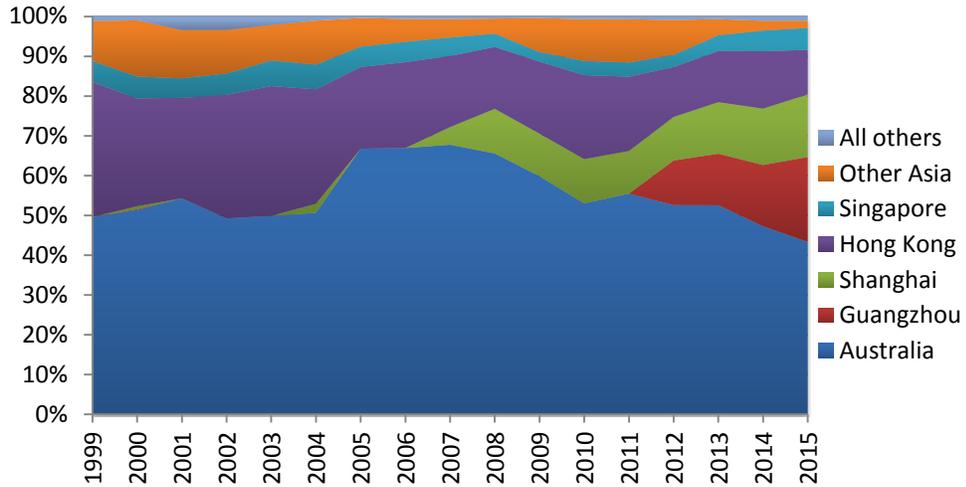
The dynamics of the wider China-New Zealand market

43. As discussed above, the New Zealand-China aviation market is overwhelmingly dominated by inbound leisure tourists.
44. In addition to the factors above, the wider New Zealand-China market contains several other characteristics:
 - i. The market involves two Chinese State carriers operating regularly, with a third (Air China) seeking to enter the market as part of the proposed alliance. This contrasts with many other countries where one main national flag carrier typically dominates the market for international air services.
 - ii. The New Zealand-China market and future growth in travel between both countries is seen as strategically important to New Zealand. The intention to form the alliance was included in the official list of announcements from President Xi's 2014 State visit to New Zealand.
 - iii. The market contains many indirect competitors including Qantas, Cathay Pacific and Singapore Airlines

The

competitive dynamics of the market look set to evolve considerably over the proposed five year term of the alliance.
 - iv. In the 12 months to February 2015, around 43 percent of Chinese travellers arrived in New Zealand via Australia (see Figure 5). This suggests that there is a significant opportunity for Chinese airlines to offer triangular services to Chinese travellers to pair a visit to New Zealand with Australia. At the same time, direct routes have grown as a proportion of Chinese arrivals, suggesting that more passengers are travelling to New Zealand as their sole destination (mono-destination travellers)

Figure 5 – Breakdown of Chinese arrivals by last port of departure (year-ended February)



Counterfactual

45. 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.
46. Any conclusions or assertions made in this report from this point forward should be considered against our assessment of the counterfactual, as described below.

Air New Zealand

Air New Zealand has also noted that regardless of whether the alliance is authorised,

51. Air New Zealand has demonstrated that it is willing to

rate. the China market is growing at an unprecedented
and China's population becomes more affluent

That said, we accept that without the alliance,

53.

Air China

55. In our view, the market opportunity for a direct service between Auckland and Beijing is simply too large for airlines to ignore. Despite the absence of a direct service, there are almost as many visitors to New Zealand each year from Beijing as from Shanghai. If the Beijing province were a country, it would be New Zealand's 11th largest tourism source market – ahead of the likes of Malaysia, Hong Kong, and Thailand – and the market is continuing to grow at a rapid rate. As one of the largest and most prominent cities in China, a Beijing service would also have considerable appeal for New Zealanders travelling to China. In our view, the only uncertainty is around how soon a service between Beijing and New Zealand would occur.
56. Air China is by far the most logical airline to operate a Beijing-Auckland service, as it is the largest international airline operating from Beijing. In the event that Air China did not operate a service to Auckland, it is likely that another airline eventually would. The most likely candidate other than Air China is Hainan Airlines. A submission from Tourism New Zealand notes that Hainan Airlines has previously considered operating a twice-weekly service from Beijing to Auckland.
- . Chinese airlines are unlikely to experience the same difficulties that Air New Zealand experienced gaining access to favourable slots at Beijing airport.
57. Overall, we consider it highly likely that Air China would operate to New Zealand in the short to medium term with or without the alliance. However, we accept that the alliance provides certainty that the service would eventuate almost immediately, and with regular frequency (daily). If the alliance were not authorised there is a risk that Air China might take a negative view of the regulatory environment in New Zealand that could push out the time-frame for commencing services.
58. In summary, our assessment of the likely counterfactual is:
- Air New Zealand continues to operate a daily service to Shanghai,
 - Air China, or another airline, commences a three times per week service between Beijing and Auckland within the next 1-3 years.

Impact on markets

Beijing

Demand for travel from Beijing is fast approaching levels that would sustain a direct service

59. China's capital, Beijing is home to around 22 million residents. It is the third largest city in the world and its airport is the second busiest by passenger traffic⁹. Many of China's state-owned companies are based in Beijing which has an economy dominated by the services sector.
60. Arrivals from Beijing province have increased steeply since 2010 as the figure below shows. While there is no airline currently offering direct services, many of these airlines offer one-stop services either on their own aircraft or through cooperative arrangements with other carriers. In particular, China Southern's entry into the New Zealand-China market has contributed to the recent growth in arrivals from Beijing by offering a second one-stop home carrier option for Chinese residents in addition to Cathay Pacific.

Figure 6 – Arrivals from Beijing since 2000

61. Air New Zealand operated between Beijing and Auckland from 2008 to 2012 with a twice weekly service.
62. However, since Air New Zealand withdrew from the market, overall traffic from Beijing province to New Zealand has increased by around 30 percent. At its current rate of growth, the business case for a direct service between New Zealand and Beijing will be hard to ignore.

⁹ <http://www.aci.aero/Data-Centre/Monthly-Traffic-Data/Passenger-Summary/Year-to-date>.

The alliance provides a low-risk business case to commence a Beijing-Auckland service immediately

63. The alliance will reduce the commercial risks for Air China entering the New Zealand market.
64. The alliance also provides incentives for Air New Zealand to ticket passengers from its domestic and international services onto Air China's Auckland-Beijing service. Without a revenue-sharing arrangement in place for the Auckland-Beijing service, Air New Zealand would be better off ticketing passengers through its Auckland-Shanghai service even if they are destined for Beijing.
 - . Having access to Air New Zealand's customer base, sales channels and market knowledge will help Air China to sell tickets to a larger proportion of New Zealand passengers than it would be able to on its own.

Figure 7 – Composition of passengers by nationality on NZ-China services

68. We have indicated in our counterfactual assessment that we consider it highly likely that a direct service between Auckland and Beijing will eventuate in the next one to three years even if the alliance is not authorised. However, the alliance would provide Air China with a more convincing commercial case for commencing such a service immediately and at a daily frequency.
69. The immediate establishment of a direct service between Auckland and Beijing is a tangible benefit of the alliance.

The alliance may constrain future growth and competitive pricing on the Auckland-Beijing route

70. The market for travel from Beijing is fairly competitive given the range of one-stop options for travellers. Air New Zealand prices its services near the higher end of the spectrum compared to its competitors (see Table 1). The fares displayed on the table below have been collated based on website queries and constitute a simple analysis aimed to provide a signal of pricing behaviour across airlines.

Table 1 – Breakdown of routing and market share for inbound Beijing traffic (year-ended February 2015)

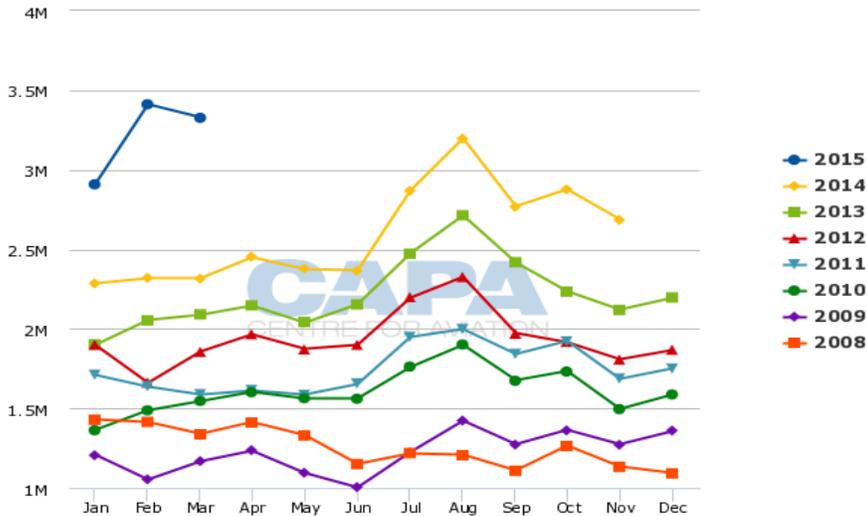
Airline			Average Fares for Beijing to Auckland¹¹	Flight times
China Southern			NZ\$1,000 to \$1,240	16.5 to 26.5 hours
Air New Zealand			\$1,260 to \$1,445	15.5 to 26.5 hours
Qantas			\$1,155 to \$1,300	21 to 30 hours
Singapore Airlines			\$1,150 to \$1,480	18 to 26 hours
Cathay Pacific			\$1,280 to \$1,500	15.5 to 26.5 hours
China Airlines			Not available	Not available
China Eastern			Not available	13 to 14 hours (direct)
Malaysian Airlines			\$1,245 to \$1,570	17 to 30.5 hours
Korean Air			\$850 to \$1,100	19 to 30 hours
Thai Airways			Not available	Not available

¹⁰ A unit of measure which airlines commonly use to denote the available capacity on its services, calculated by multiplying the number of seats available on its aircraft by the number of kilometres the aircraft travels.

¹¹ Fares have been collated based on website queries on each individual airline's websites for travel in October. The lowest and highest economy fares available are displayed as a range (excluding promotional deals).

71. The ‘big three’ state-owned Chinese carriers (China Southern, China Eastern and Air China) have all pursued aggressive growth strategies over the last decade, capitalizing on growing demand for international air travel among Chinese residents. Figure 8 shows the year on year change for these carriers broken down on a monthly basis.

Figure 8 – Monthly overall international passenger numbers for Chinese carriers



72. In New Zealand, both China Southern (from three times a week to twice daily in under three years) and China Eastern (from a daily seasonal service to a year round four times weekly service in under a year) have commenced and grown their services at unprecedented rates.
73. These airlines’ growth strategy requires very competitive pricing to ensure they are able to earn sustainable yields on new services.
 . However, the market is made up of predominantly price-sensitive travellers. Non-business travellers accounted for around 90 percent of New Zealand-China traffic for the 12 month period to February 2015.
74. If Air China were to enter the Beijing market on its own, we would expect to see a similar growth strategy employed to that of the other Chinese carriers.

Although Air New Zealand is currently in a high-growth phase, it is likely to take a more conservative and managed approach to growth than Air China. Under the alliance, Air New Zealand may object to Air China adding too many seats too quickly, as too much growth could reduce yields and result in losses.

76. Wellington Airport alluded to the impact of the alliance on Air China’s incentives for growth in its submission, stating, “It will be important to assess the extent to which the Alliance could have the effect of restricting capacity on a route likely to encounter strong demand growth”.
77. We consider it likely that under an alliance with Air New Zealand, Air China would face less incentive to put in capacity ahead of demand. This would reduce the prospects of lower fares being offered to travellers. It is possible that competition from a range of one-stop carriers in the market (see Table 1) could help to prompt the applicants to pursue more ambitious growth.

Shanghai

Demand and competition for travel from Shanghai is growing rapidly

78. Around 24 million people reside in Shanghai, making it one of the most populous cities in the world. It also houses the 16th busiest airport in the world by passenger traffic¹² and the busiest container port by volume¹³. Shanghai also has the highest GDP of any city in China and is an attractive tourist destination.
79. As evidenced by Figure 9, arrivals from Shanghai have risen rapidly in the last decade. Since 2012, total market demand has grown by 50 percent.

Figure 9 – Arrivals from Shanghai since 2000

80. In particular, since Air New Zealand increased its frequency from four to five weekly services in 2012 and to daily in 2013, its market share e by and respectively.

¹² <http://www.aci.aero/Data-Centre/Monthly-Traffic-Data/Passenger-Summary/Year-to-date>.

¹³ <http://www.worldshipping.org/about-the-industry/global-trade/top-50-world-container-ports/>.

81. These figures do not capture the impact of China Eastern's seasonal service from December 2014 to March 2015. China Eastern commenced services between Auckland and Shanghai four times a week in December 2014, increasing to daily from January 2015. During this period, its market share was around . The airline recently confirmed it would be operating four weekly services year round from September 2015, increasing to daily in January 2016.

It is difficult to assess whether the Shanghai market is big enough to sustain competition between two carriers. While there has been significant growth, . China Eastern's entry into the market is likely to elicit a competitive response in the short-term.

83. Air New Zealand has claimed that a key benefit of the alliance is

will help Air New Zealand to better compete with China Eastern.

84. Despite its relatively short presence in the market, China Eastern carried around of arrivals to New Zealand from Shanghai in the 12 month period ending February 2015 (if limited to the period in which China Eastern operated from December 2014 to March 2015). It is reasonable to expect that once China Eastern commences a year round service, it will be in a position to acquire a significant proportion of the market for travel between Shanghai and Auckland.

- . Air New Zealand possesses a strong market presence in the New Zealand-Shanghai market as evidenced in Figure 10 below. However,

Figure 10 – Market share for arrivals from Shanghai (year ended February 2015)

86. [redacted] is the strength of competing carriers on the ‘other end’ of the route. Traffic on New Zealand – China routes is predominantly inbound (around 78 percent of total origin-destination traffic). This means that airlines with stronger sales and distribution channels in the China market will have an advantage over Air New Zealand when it comes to marketing and selling tickets on their services.
87. Table 2 illustrates this situation. Air New Zealand contracts with [redacted] agents in China, following 8 years of operation. In contrast, Air China has [redacted] sales units in the country. The alliance provides Air New Zealand with an opportunity to leverage Air China’s established sales strength to [redacted].

Table 2 – Air New Zealand’s distribution network

88. The importance of a local partner is further highlighted by figures provided by Air New Zealand on its sales channels. As shown below,

Table 3 – Air New Zealand indirect sales (through travel agents) in Hong Kong (HKG) and Shanghai (PVG)

. Air New Zealand has stated in its confidential counterfactual that

90. By providing Air New Zealand with a local partner, the alliance improves the chances of competition . This is a tangible and significant benefit of the alliance. In its submission, Auckland Airport recognised the continued competition on Auckland-Shanghai as a benefit of the alliance.

The alliance is unlikely to impact prices for travel between Auckland and Shanghai

91. Air New Zealand's strong presence in the Shanghai market is due in part to the significantly shorter travel times (compared to one-stop services) and competitive pricing.
92. The fares displayed on the table below have been collated based on website queries similar to those in Table 1 above and constitute a simple analysis aimed to provide a signal of pricing behaviour across airlines.

Table 4 – Breakdown of routing and market share for inbound Shanghai traffic (year-ended February 2015)

Airline			Average Fares for Shanghai to Auckland ¹⁴	Flight times
Air New Zealand			NZ\$1,240 to \$1,340	11.5 hours (direct)
Qantas			\$845 to \$1100	15 to 28 hours
China Eastern			Not available	Not available
Singapore Airlines			\$1,120 to \$1,250	23 to 25.5 hours
China Southern			\$1,240 to \$1,345	18 to 23 hours
Cathay Pacific			\$1,000 to \$1,240	14.5 to 23 hours
Malaysian Airlines			\$940 to \$1,620	21.5 hours
Korean Air			\$845 to \$1,075	14.5 to 33 hours
Thai Airways			\$1,280 to \$1,705	23 to 37 hours

93. While there are airlines such as Qantas that charge significantly lower fares in the market for one-stop services, Air New Zealand’s fares do not appear to be excessively high.
94. The fact that Air New Zealand’s fares are broadly comparable to China Southern (which is generally seen as a low-price competitor in other markets) highlights the challenges that Air New Zealand faces in attracting high yielding Chinese passengers. In most other markets, we would expect an airline operating a direct service to price its services at a premium compared to airlines offering indirect services. We have not observed this in the Shanghai market.
95. Unlike fares for services to Beijing, Cathay Pacific’s fares do not align with Air New Zealand’s on services to Shanghai. This may be due to the need for it to compete with Air New Zealand’s non-stop Shanghai service. In the case of Beijing, both airlines operate one stop services. Therefore Cathay Pacific has little to no incentive to differentiate its prices from Air New Zealand as it would simply be reducing its yields from passengers travelling on its services with Air New Zealand between New Zealand and Hong Kong.
96. The alliance itself is unlikely to impact on how Air New Zealand prices its Shanghai service. In particular, Air New Zealand will face strong competition from China Eastern as well as one-stop operators regardless of whether the alliance is authorised.

¹⁴ Fares have been collated based on website queries on each individual airline’s websites for travel in October 2015. The lowest and highest economy fares available are displayed as a range (excluding promotional deals).

The alliance would provide Air New Zealand with more favourable access beyond Shanghai and the potential for cheaper connections for passengers

97. We requested data from Air New Zealand on the number of passengers travelling and connecting to/from Shanghai. We also requested data for the airline on which connecting passengers were ticketed. Connecting traffic makes up around _____ of all passengers travelling between Auckland and Shanghai.

_____, the alliance will impact on Air New Zealand's access into the greater China market

98. The data we received showed that Air New Zealand relies most heavily on _____ to connect its passengers to Chinese destinations beyond Shanghai.

Table 5 – Breakdown of connecting traffic beyond Shanghai

99. Around _____ of the connecting passengers could have travelled with Air China from Shanghai but travelled with another airline. This could be due to more favourable interline rates through other airlines or the timing of connecting services.

100. This suggests that, _____, the alliance is likely to provide Air New Zealand with greater opportunities to code-share on Air China's domestic services from Shanghai. In particular, with the applicants sharing revenue on the route, Air China would be incentivised to reduce the rates it charges to Air New Zealand for code-share services¹⁵. The applicants would both seek to optimise their flight schedules to ensure as many connecting passengers as possible travel on Air China's services.

101. Accordingly, we would expect the alliance to provide the potential for cheaper connections to and from points in China via Shanghai. As long as the market remains competitive, we would expect at least a proportion of the savings to be passed on to passengers.

¹⁵ We would expect a code-share agreement with Air China to offer more favourable rates for Air New Zealand than the interline agreement the latter currently has in place with _____

Greater New Zealand-China market

103. , the alliance will have some impact on connecting passengers, with Chinese residents being able to travel to New Zealand from four gateways instead of three with the addition of a direct service from Beijing to compete with existing services from Shanghai, Guangzhou and Hong Kong.

105. However, there is likely to be some overlap between the Air New Zealand/Air China alliance and the Air New Zealand/Cathay Pacific alliance.

. Our detailed analysis of the impact of both alliances operating in parallel is provided in paragraphs 109 to 118.

Guangzhou and Hong Kong are likely to continue to be strong gateways to secondary Chinese cities

106. The alliance is unlikely to capture much traffic to and from secondary Chinese cities given the applicants intend to primarily serve the point-to-point markets from Beijing and Shanghai to New Zealand.

107. Guangzhou and Hong Kong appear to be relatively popular connecting options for Chinese passengers travelling to and from New Zealand from provinces other than Shanghai and Jiangsu (see Table 6).

108. China Southern, Air New Zealand and Cathay Pacific are likely to continue to serve the greater Chinese markets over Guangzhou and Hong Kong. As the New Zealand Chinese Association noted in its submission, the New Zealand-China market is relatively competitive.

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Table 6 – Breakdown of inbound traffic from China by residence province and connecting airport (most popular connecting airport per province highlighted; data for year ended February 2015)

Residence province	Connecting airports									Total	% of China inbound traffic
	Shanghai	Guangzhou	Hong Kong	Singapore	Brisbane	Melbourne	Sydney	Coolangatta	Other		
Beijing	9.0%	21.6%	11.6%	7.8%	15.7%	12.2%	14.3%	3.6%	4.3%	35,152	15.59%
Shanghai	50.1%	5.7%	5.6%	6.1%	7.0%	8.9%	11.1%	2.8%	2.7%	41,424	18.37%
Zhejiang	26.4%	10.7%	23.9%	2.9%	8.5%	10.6%	9.6%	5.2%	2.3%	16,832	7.46%
Jiangsu	26.9%	10.0%	8.3%	3.1%	11.0%	13.4%	18.4%	6.9%	2.0%	14,240	6.31%
Guangdong	0.6%	41.6%	17.9%	11.0%	5.1%	12.4%	7.1%	1.2%	3.2%	37,344	16.56%
Liaoning	11.4%	30.3%	2.7%	1.6%	14.1%	11.2%	14.4%	5.2%	9.1%	7,024	3.11%
Shandong	12.0%	27.4%	7.7%	1.6%	12.9%	9.8%	15.6%	6.3%	6.6%	7,056	3.13%
Sichuan	3.1%	16.7%	10.7%	2.7%	17.7%	11.3%	24.8%	11.5%	1.6%	11,312	5.02%
Rest of South and Central China	6.8%	27.2%	13.1%	6.2%	15.0%	11.2%	13.9%	4.4%	2.2%	33,024	14.64%
Rest of Northern China	10.3%	28.2%	8.9%	3.1%	15.8%	12.5%	13.9%	3.9%	3.4%	22,096	9.80%
All	17.2%	22.1%	11.8%	6.0%	11.4%	11.3%	12.9%	4.0%	3.2%	225,504	100%

Figure 11 – Map of China (taken from http://d-maps.com/carte.php?num_car=11572&lang=en)



Impact on other alliances

The Air New Zealand/Air China alliance overlaps with the Air New Zealand/Cathay Pacific alliance

109. Air New Zealand has stated that
as Shanghai, Beijing and Hong Kong are complementary gateways with minimal overlap in terms of connecting traffic.
110. Our analysis suggests that this is not completely true¹⁶. Guangzhou appears the most popular connecting option for Chinese passengers travelling to New Zealand from cities outside of Shanghai, Zhejiang, Jiangsu and Sichuan (see Table 6 above). However, Hong Kong and Shanghai appear to account for similar numbers of passengers travelling to New Zealand from Beijing, Zhejiang, Shandong, and the rest of China. This suggests that to some extent, Hong Kong and Shanghai are competing as gateways to other destinations in China.

112.

While we understand this rationale, we consider that competition in the China market will be weakened if Air New Zealand is allowed to cooperate with two alliance partners, particularly when both Shanghai and Hong Kong (and potentially Beijing) appear to be competitive gateways into that market.

113. routes into
China on which Air New Zealand and Air China do not operate direct. The reason for this is that Cathay Pacific, if acting to maximise profits, would elect to benchmark its pricing with Air New Zealand for services into cities in China outside of Shanghai and Beijing. If Cathay Pacific were to charge a lower fare, it would simply be reducing its profit margins in comparison to Air New Zealand given the revenue-sharing arrangement the two airlines have on Auckland-Hong Kong.

114. Air New Zealand is also likely to align its fares to other cities in China over all its gateways so that it is not cannibalising traffic from other services in its network. If the alliance with Air China is approved, Air New Zealand could then look to charge similar fares for passengers travelling to cities in China over Hong Kong, Shanghai and Beijing.

¹⁶ We are unable to confirm whether Beijing would act as a complementary gateway given there are no direct services at present and hence no data on connecting passengers to/from Beijing.

115. In our view, the overlap between both alliances creates a risk that connecting services in China operated by Air New Zealand and its alliance partners will be similarly priced, resulting in artificially high prices for some destinations compared to the counterfactual. However, indirect competition from airlines providing one-stop services (such as Qantas, Singapore Airlines and Malaysia Airlines) are likely to constrain the applicants' ability to increase fares, particularly given that the market is heavily inbound and consists of primarily leisure travellers who are more likely to take a less direct routing to take advantage of lower fares.

There is little overlap between Air New Zealand's alliance with Singapore Airlines and the proposed alliance with Air China

117. Our analysis indicates that around 5 percent of passengers travelling between New Zealand and China do so via Singapore. This proportion has not changed following the commencement of the Air New Zealand/Singapore Airlines alliance in December 2014.
118. Travelling from Auckland via Singapore is not viable for many parts of China, often involving circuitous routings that can make the flying time 2-3 hours longer than travelling via Australia, Hong Kong, Guangzhou or Shanghai.

Impact on bilateral relationship with China

119. Under the NZ Inc China Strategy, New Zealand had a target of reaching \$20 billion in two-way goods trade by 2015. This target was reached in the second quarter of 2014. In March 2013 the leaders of both countries revised the trade target up to \$30 billion by 2020.
120. The NZ Inc China strategy aims to grow services trade with China by 2015, with targets of a 60 percent increase for tourism and a 20 percent increase for education.
121. Auckland Tourism, Events and Economic Development commented on the benefit the alliance would provide for the education sector in their submission supporting the alliance. China is New Zealand's biggest source of international students, making up 28.4 percent of all enrolments for the second semester in 2014. The value of international students studying in Auckland has reached \$1.6 billion a year.

122. Sister Cities New Zealand, a movement established to promote people to people exchanges between countries, also submitted support for authorisation of the alliance. They point to a Memorandum of Understanding which was signed between Local Government New Zealand and the Chinese People's Association for Friendship with Foreign Countries. The agreement establishes a Mayors' Forum to strengthen connections between New Zealand and more than 600 cities and provinces in China. The agreement has enabled more New Zealand mayors to travel to China to support business, tourism and education opportunities.
123. Authorisation of the alliance would likely be interpreted as a positive development in the bilateral relationship between New Zealand and China. The various initiatives and targets referred to above highlight the increasing importance of China as a bilateral partner for New Zealand, not just for trade and tourism but in other areas like education and investment.
124. There is the potential for the alliance to make it easier to negotiate an 'Open Skies' agreement with China. However, an 'Open Skies' agreement is likely to require more than an arrangement between two home carriers, particularly given the precedent it would set for China's other air service agreements. Even in the absence of an open skies agreement, China has previously been prepared to amend the agreement when necessary in order to ensure that sufficient capacity is available ahead of demand. The benefit of the alliance in this instance is not significant enough to have a bearing on our analysis.

Potential for market entry

The alliance would have minimal impact on the prospects for market entry onto existing or future New Zealand-China routes

125. A key consideration with any alliance application is the extent to which the proposed conduct could change the incentives for other airlines to enter the market. In this case, we need to consider whether the alliance would create a barrier to entry both on the Auckland-Shanghai and Auckland-Beijing routes, and in the New Zealand–China market more generally.

126. The highly regulated nature of the global aviation industry means that it is extremely unlikely that an airline from a third country (i.e. a country other than New Zealand or China) would operate services between China and New Zealand. In order to do this, the government of the airline involved would need to have exchanged 'fifth freedom' traffic rights with both New Zealand and China. New Zealand has exchanged fifth freedom traffic rights with dozens of countries, but far fewer countries are likely to have exchanged these rights with China. Even if an airline does have access to the necessary traffic rights, the business case for operating a fifth freedom service between China and New Zealand is unlikely to be strong. An airline with slots at the busy Chinese airports is likely to want to use these in its home market. As a result, any additional competition in the New Zealand-China market is likely to come from other Chinese airlines.
127. New Zealand's air services agreement with China permits 42 weekly frequencies to be operated by airlines of each side. The Chinese government's approach is to ensure its carriers are able to grow services but within restrictions which it considers to represent sustainable growth. Chinese officials are aware that New Zealand is willing and able to exchange further traffic rights including removal of all restrictions on flying between both countries. The air services agreement is very unlikely to constrain further growth or entry by Chinese airlines.
128. China's aviation industry is dominated by three rapidly growing State-owned airlines: Air China, China Southern, and China Eastern. While these airlines are stand-alone entities, it is well known that they do not operate entirely independently of one another. The Chinese government has effectively divided the market among the three airlines on geographical lines:
- China Southern is the dominant airline in the South of China, with its primary hub in Guangzhou. It is a member of the SkyTeam global alliance.
 - China Eastern is the dominant airline in the East of China, with its primary hub in Shanghai. It is a member of the SkyTeam global alliance.
 - Air China is the dominant airline in the North of China, with its primary hub in Beijing. It is a member of the Star Alliance.
129. In addition to the three State-owned airlines, there are a number of other airlines in China that are either privately owned, or operate as subsidiaries of the three State-owned airlines. These airlines are rapidly increasing in size and beginning to expand beyond China into new international markets. Of these, the three largest are Hainan Airlines (privately owned); Xiamen Airlines (a subsidiary of China Southern); and Shenzhen Airlines (a subsidiary of Air China).

130. Direct competition between Chinese airlines on international routes is rare, both because of the geographical separation of the State-owned airlines and because of China's informal 'one airline, one route' policy.¹⁷ The basis of this policy is the philosophical belief that Chinese airlines should compete with other international carriers before competing amongst themselves. There are some exceptions to this policy. For example, both Air China and China Eastern operate services between Shanghai and Sydney.
131. It could be argued that the alliance would create a disincentive for Air New Zealand to compete head to head with Air China on the Auckland-Beijing route. However, we believe the likelihood of this occurring is very low in any case.

. A new, larger airport is currently being constructed in Beijing, but it will not be completed until 2018 at the earliest.

. With the advantage of a hub in Beijing, Air China is unlikely to experience the same issues.

132. One potential concern is that the alliance may have a detrimental impact on competition in the greater New Zealand–China market, by reducing the incentives for airlines to establish new routes (other than Auckland-Shanghai or Auckland-Beijing). The alliance would clearly provide the applicants with a competitive advantage that other airlines could not hope to replicate. However, the large proportion of point-to-point traffic on the Auckland-Shanghai route (which we would also expect to see on the Auckland-Beijing route) means that any market distortions will be largely contained to the Shanghai and Beijing catchment areas. The argument that the alliance would reduce the prospect of a service between Chengdu and Auckland, for example, is difficult to substantiate.
133. However, we do believe that the alliance might have a negative impact on the likelihood of a direct service between Beijing and Christchurch (or other cities in New Zealand). This is discussed further in paragraphs 138 to 150. With the exception of this route, we expect the alliance to have a very minimal impact on prospects of market entry, both on existing routes or potential future routes.

¹⁷ <http://centreforaviation.com/analysis/skyteam-seeks-clarity-on-proposed-china-southern-air-china-joint-a380-operation-97256>

¹⁸ <http://ajw.asahi.com/article/asia/china/AJ201412270029>

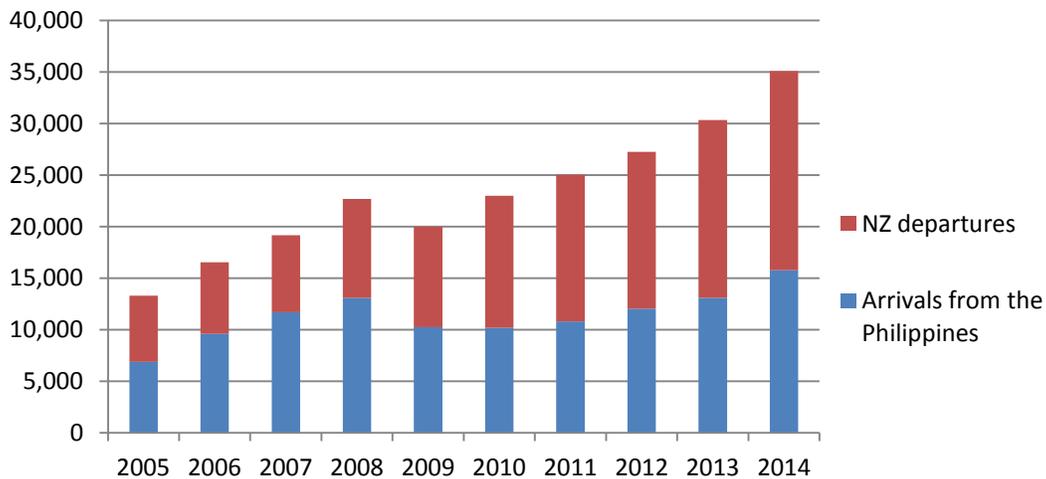
Concerns raised over Air New Zealand’s alliance strategy and its impact on future entry into the wider New Zealand-Asia market

- 134. A number of submissions (Christchurch Airport, Wellington Airport and the New Zealand Airports Association) have referred to the impact the alliance will have on the overall composition of routes between New Zealand and Asia. If the alliance is authorised, Air New Zealand and its alliance partners would carry around 65 percent of New Zealand-Asia traffic.

- 135. We accept to some extent that alliances are a necessary strategy for Air New Zealand to strengthen its presence in other markets. We also consider that it is highly unlikely that fifth freedom carriers would choose to operate between New Zealand and points in Asia. However, given all three global alliances have at least one member operating a service between New Zealand and an Asian hub, most airlines have viable options to code-share to New Zealand.

- 136. More broadly, we do not view Asia as a single market. Foreign airlines are likely to attach a greater weight to the point-to-point market when developing a business case for services into New Zealand. As an example, Philippine Airlines has recently announced it will operate a four-weekly Manila-Cairns-Auckland service from December 2015. It has made this decision despite Air New Zealand’s alliance with Singapore Airlines which provides for Air New Zealand to code-share to the Philippines. Notably, the growth in the market for travel between New Zealand and the Philippines has reached a level where a service between both countries is commercially viable (see Figure 12).

Figure 12 – Market for travel between New Zealand and the Philippines



137. Other examples of airlines recently commencing or poised to commence services to New Zealand from Asia include:

- China Airlines, which will operate three weekly Taipei-Melbourne-Christchurch flights from 25 October 2015, over the New Zealand summer and alongside its Taipei-Sydney-Christchurch service.
- China Eastern, which will operate four weekly Auckland-Shanghai flights year-round from September 2015.
- We are aware that China Southern intends to commence services from Guangzhou to Christchurch in late 2015

Impact on other New Zealand regions

138. Christchurch Airport has recently expressed concern that alliances are reducing opportunities for airlines to operate direct services to Christchurch (or any city other than Auckland). It argues that this is compromising the integrity of New Zealand's open skies policy. While it has not explicitly opposed the current application, Christchurch Airport is of the view that it will not have a material positive impact on either South Island exporters or the South Island tourism industry. Christchurch Airport has urged us to conduct a detailed analysis to be satisfied that the Alliance does not "practically contribute to the reduction in opportunity for future direct international air services to destinations other than Auckland".

139. The Tourism Industry Association of New Zealand has also noted the importance of ensuring that the benefits of alliances are spread throughout the country.

140. In our experience, the benefits of alliance agreements have generally been weighted towards Auckland. This reflects the fact that Air New Zealand has adopted a single-hub strategy, which attempts to direct as many passengers through Auckland as possible. When another airline enters into an alliance with Air New Zealand, it will gain favourable access to Air New Zealand's domestic network and lose the incentives it might have had to differentiate itself from Air New Zealand by operating to another city.

141. In particular, this is evidenced by the alliance between Air New Zealand and Cathay Pacific. The original application for this alliance suggested that it would increase the likelihood of new routes (such as a Hong Kong-Christchurch route) being developed in the future. However, the subsequent application for reauthorisation in 2014 made no mention of this. The airlines are no longer suggesting that a Hong Kong-Christchurch route is likely.¹⁹

¹⁹ This was not a significant factor in our analysis of the alliance between Air New Zealand and Cathay Pacific, as we considered it unlikely that a Hong Kong-Christchurch service would occur even without that alliance.

142. We have also previously concluded that Air New Zealand's trans-Tasman alliance with Virgin Australia has not delivered benefits to all regions. In that case, the regions that have benefitted least are smaller regional cities such as Hamilton and Dunedin, where international services have been reduced or suspended. While the Air New Zealand/Virgin Australia Alliance has affected different regions, we believe that the underlying cause is the same (that the Alliances reduce the incentives for airlines to differentiate themselves from Air New Zealand).
143. On the other hand, Singapore Airlines recently announced it would operate 27 additional flights to Christchurch over the 2015/16 summer season. This is a slightly different case given that Singapore Airlines was already operating to Christchurch when it entered into an alliance with Air New Zealand. However, it provides some evidence that alliances will commence new or expanded services in other regions where sufficient demand exists.
144. To a certain extent, Air New Zealand's alliances do limit the incentives for its partners to operate to cities outside of Auckland. However, the practical implications of this are limited as none of Air New Zealand's current alliance partners would have strong incentives to operate to airports outside of Auckland, even if they were not cooperating with Air New Zealand.
145. We are confident that none of the alliances that have been authorised in New Zealand to date have resulted in an airline operating to Auckland when it would have otherwise operated to Christchurch.
146. In the case of the current application, we would expect any impact on the likelihood of direct services to other airports to be minimal, at least in the short-to-medium term. The key reason for this is that Air China is a member of the Star Alliance. As such, it already has relatively good access to Air New Zealand's domestic network. In our view, it is unlikely that Air China would consider operating a service to Christchurch until it has firmly established itself in the Auckland market, regardless of whether it operates under an alliance with Air New Zealand.
147. Furthermore, we are aware that China Southern intends to commence services from Guangzhou to Christchurch in late 2015. If such a service were to eventuate, the prospects of Air China entering Christchurch in the short term would further diminish.
148. We also note that Hainan Airlines has a substantial hub in Beijing. Hainan Airlines would be well positioned to operate a service to Christchurch in the future if Air China and/or Air New Zealand did not. We understand that Hainan Airlines has expressed an interest in the New Zealand market in the past.

149. The competitive dynamics of the China market are rapidly evolving. While we have concluded that the alliance will not be a barrier to Air China commencing a potential Beijing-Christchurch route in the short-term, we note that it has the potential to become a much more significant issue in the future if demand for travel to the South Island continues to grow, and potentially within a relatively short timeframe (in the range of 3-5 years).
150. In the short-term however, any benefit that the alliance may have in the Auckland market is likely to flow through to other parts of the country to some extent. While we accept that passengers are more likely to travel to the South Island if their port of arrival is Christchurch, we would still expect a relatively large proportion of Chinese visitors arriving on the Alliance routes to travel throughout the country.

Other impacts

The alliance would provide benefits for the tourism industry

151. The alliance places greater incentives for the applicants to work together to market New Zealand as a destination for Chinese residents. If Air China were to operate to New Zealand on its own, it would have little incentive to market New Zealand above other destinations on its network.
152. Air New Zealand has been involved in several marketing initiatives with Tourism New Zealand in China and is likely to continue with such campaigns, regardless of the alliance, given the growing market for inbound passenger travel from China.
153. Tourism New Zealand points out that arrivals between 2011 and 2014 grew by 125 per cent from Shanghai province residents, 134 per cent from Guangdong province residents, but only 68 per cent for Beijing province residents. While growth out of Beijing has been strong, it has lagged behind the other major provinces which have benefitted from direct air services.
154. Overall, the alliance will provide benefits for the tourism industry through the incentives it places for both applicants to market their routes and the access Air New Zealand gains to Air China's sales channels as identified in paragraphs 86 to 90. A new service to Beijing will also have a stimulating effect for tourism, similar to that seen when airlines have entered the Shanghai and Guangzhou markets. All three tourism bodies that submitted on the alliance (Tourism New Zealand, Tourism Industry Association and Auckland Tourism, Events and Economic Development) supported authorisation.

The further alignment of frequent flyer programs would provide some benefits to New Zealand

155. The applicants propose to provide reciprocal premium customer handling arrangements for qualifying passengers in each of China and New Zealand, over and above the existing Star Alliance arrangements. We consider these benefits to be modest given they apply to a smaller proportion of both applicants' customer base.
156. A more tangible benefit is the expansion of the applicants' reciprocal frequent flyer arrangements that currently exist under the Star Alliance. Improvements may include:
 157. Consumers, in particular business travellers, would have the ability to earn and redeem frequent flyer points on either airline's services. While we have considered these benefits as modest in previous alliance applications, the Air New Zealand and Air China alliance application is an exception given the size of the Chinese market. Effectively, Air New Zealand operated services from Shanghai are made available to Air China's strong frequent flyer customer-base.

The alliance would provide for increased freight competition

158. The alliance does not include cooperation in relation to cargo carried on the belly hold of either applicants' passenger services.
159. Air freight comprised around 16 percent of total trade between New Zealand and China by value and tends to comprise high value, perishable goods.
160. The alliance provides a new route for exporters into China and a competing carrier in the air freight market.
161. Air China has chosen to operate Airbus A330-200 aircraft on the proposed daily service between Auckland and Beijing. The applicants have informed us that the belly hold freight capacity of this aircraft is approximately 10 tonnes. Compared to a counterfactual where Air China operates 3 weekly services (30 tonnes of freight capacity), the alliance provides for an additional 4 weekly services or an additional 40 tonnes of freight capacity.

162. there would be flow on benefits for exporters who will be able to choose between cargo carriage offered by Air New Zealand and China Eastern.
163. Overall, the alliance provides notable benefits for the air freight market.

Appendix – Statutory analysis

Specific Criteria in Part 9 of the Civil Aviation Act

1. This section examines whether and how the Alliance Agreement complies with Part 9 (principally section 88) 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.

2. The Alliance and Code-share Agreements cover services by airlines designated and operating under the Agreement between the Government of the People's Republic of China and the Government of New Zealand and the Government of Hong Kong relating to Civil Air Transport 1993, and Memoranda of Understanding signed November 2014, April 2012 and March 2004.

4. All the services contemplated by the alliance arrangements are thus permitted by the relevant international agreements. 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”***
5. 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***
6. 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.

7. The references to commissions in the agreements are:

8. These provisions do not have the purpose or effect of breaching the terms of either of these commission regimes. There is no prohibition of 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***

9. The Alliance Agreement does not set tariffs itself, but put in place a process for setting tariffs. The Agreement does not contain any provisions that unjustifiably discriminate between consumers in terms of this paragraph.

10. The broader issue of the impact of the Agreement on the tariffs that may be faced by consumers generally or particular classes of consumers if the Alliance is authorised, is addressed elsewhere 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***

12. This wording does not

13. The Agreements do not impact on the right or ability of any other operating carrier, or code-share partner of another operating carrier, to enter into and put tariffs in the market.

15. Thus, in relation to tariffs, the Agreements do not have the effect of excluding any supplier of international carriage by air from participating in the market to which they relate.

(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

(f) Prevents any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding

No penalty is payable when a party withdraws on reasonable notice.

21. While simple code-share arrangements often provide for relatively short notice periods (sometimes as short as a schedule period), alliance arrangements often envisage and require a greater degree of commitment by the parties. Withdrawal by one party could cause considerable disruption to the other party. Therefore, longer notice periods may be appropriate. This is the first revenue sharing alliance Air China has entered into and it will be seeking some certainty.

23. The Agreements do not contain any provisions that prevent any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding.

Conclusion on section 88(4)

24. There are no provisions in the Alliance Agreement or the Code Share Agreement that fall within any of the prohibitions in 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.

25. 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.
26. Comity is not defined in the Act and the Act is the only instance of the use of the term in New Zealand legislation.
27. “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”. In very similar vein is Chambers: “The international courtesy between nations in which recognition is accorded to the laws and customs of each state by others”. 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.
28. Most international code-share arrangements will require approval in two 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 two regulators will be applying different legislation. The impacts of a proposed Alliance may also be different in the two countries.

29. However in this case, we consider that comity could be a factor weighing in favour of authorisation. The Heads of Agreement between Air China and Air New Zealand was announced during a state visit to New Zealand by President Xi in November 2014 with both countries' leaders present at the signing. It was thus positioned as part of a broader relationship between New Zealand and China. While all major Chinese airlines are state owned, Air China is particularly close to the government. To deny authorisation could damage (although only in a minor way) the relationship between New Zealand and China.

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.

31. 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.

32. 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.

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

COMMERCIALLY SENSITIVE

COMMERCIALLY SENSITIVE

COMMERCIALLY SENSITIVE

COMMERCIALLY SENSITIVE