AIR NEW ZEALAND / AIR CHINA ALLIANCE REAUTHORISATION

Detailed analysis

Ministry of Transport

March 2021

Contents

Executive summary

1. Air New Zealand Limited (Air New Zealand) and Air China Limited (Air China) have applied for reauthorisation of their Strategic Alliance Agreement (the Alliance), pursuant to section 88 of the Civil Aviation Act 1990 (the Act). The effect of authorisation under this section is that the arrangements under the Alliance are exempt from the provisions of the Commerce Act 1986 that prohibit arrangements substantially lessening competition.

2. The Ministry of Transport (the Ministry) recommends that the Minister of Transport reauthorise the Alliance.

3. We consider the Alliance has provided, and will continue to provide, real benefits to New Zealand. It provides greater international airline capacity (number of seats and flights) into New Zealand and will be vital as the New Zealand tourism industry seeks to recover from the impact of COVID-19.

4. We also conclude that the Alliance meets the statutory conditions allowing it to be authorised under section 88 of the Civil Aviation Act.

Introduction

1. The Minister of Transport is responsible for authorising or declining applications for airline alliances under the Act. The Ministry provides advice to the Minister on whether authorisation would be consistent with the criteria set out in the Act and in New Zealand's interest.

2. The effect of authorisation is that the arrangements making up the Alliance are exempt from the provisions of the Commerce Act that prohibit arrangements substantially lessening competition.

3. This report provides a detailed summary of the Ministry's analysis of the application from Air New Zealand and Air China (the Applicants) for reauthorisation of the Alliance.

4. Similar to our approach to the Qantas – American alliance reauthorisation (considered recently) this analysis will account for the potential benefits, risks and unknowns of authorising an airline alliance under COVID-19 conditions.

5. The Alliance was initially authorised in late 2015 for a period of five years ending 31 March 2021. The Applicants are seeking reauthorisation of the Alliance for another five years, until 31 March 2026.

Background on airline alliances

6. International aviation is governed by a global network of thousands of bilateral air services agreements between countries. These agreements often restrict the destinations airlines are able to serve and the capacity (number of seats or flights) 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.

7. No single airline can operate every possible route in the world. However, with alliance arrangements, airlines can expand their reach by effectively combining their networks.

8. In order to overcome the restrictions imposed in bilateral air services agreements, and the inability to serve all routes with their own aircraft, airlines have developed several means of working with one another to expand their global reach. Co-operation between airlines generally reduces competition between them to a degree, and can take a number of forms.

   - *Interline agreement*: where one airline buys tickets for travel on another airline at a pre-determined price. This is the mechanism through which (for example) Qatar Airways is able to sell its passengers a ticket from Doha to Wellington via Auckland, even though it does not itself operate a service from Auckland to Wellington.
     - A Special Prorate Agreement (SPA) is a special case of an Interline agreement, whereby two airlines agree on the apportionment of fares on journeys where each airline operates at least one leg.
   - *Code-share arrangement*: an agreement through which an airline is effectively given the ability to sell seats on flights operated by another airline as if it were operating that flight with its own aircraft. Code-share agreements are relatively common and, without additional cooperation, rarely raise competition issues unless they involve the only airlines flying a route.

- *Revenue-sharing alliance*: an extensive commercial agreement in which two or more airlines agree to share revenue in one or more markets and to cooperate on all aspects of pricing, scheduling and service delivery. These arrangements are generally subject to a much higher level of regulatory scrutiny as they have the potential to reduce competition.

- *Global airline alliance*: many airlines are members of one of the three global alliance groups – Star, Oneworld and Skyteam. Members of global alliances work together to provide services to consumers, by cooperating in areas such as marketing, scheduling, ticketing, and frequent flyer schemes. The level of cooperation differs between members. However, it is common for members of the same group to enter into interline and code-share agreements with one another.

9. The Alliance provides for all of the above types of arrangements, which involve varying levels of coordination between the applicants in relation to: revenue sharing, code-sharing, and network planning (including capacity) on direct services between New Zealand and China.

10. Alliances can result in benefits to consumers, for example, better access to connecting flights, more choices of routes and destinations, and the ability to earn and redeem frequent flyer points across the networks of all participating airlines. Alliances also have the potential to reduce costs for airlines, which in competitive markets, results in lower airfares for consumers. However, if alliances reduce or eliminate competition in a market, this can lead to higher airfares or reduced services.

11. 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 and to compete on a global scale. In saying this, each alliance agreement should be carefully scrutinised to ensure it delivers benefits that counteract any negative impacts that may result from a reduction in competition.

12. The Alliance is one of several significant alliances that have been authorised. Other alliances approved by Ministers include:

    - the British Airways – Qatar Airways Alliance
    - the Qantas Airways – Emirates Master Coordination Agreement
    - the Qantas Airways – American Airlines Joint Business Agreement
    - the Air New Zealand – Singapore Airlines Alliance
    - the Air New Zealand – Cathay Pacific Alliance
    - the Air New Zealand – United Airlines Side Agreement
    - the Air New Zealand – Virgin Australia Alliance (not in place anymore)

13. Air New Zealand's profitability improved since the airline started its alliance strategy within the Pacific Rim network, with a 4.5 percent increase between the 2011 - 2012 and 2017 - 2018 financial years.

The Applicants

Air New Zealand

14. Air New Zealand is New Zealand's national carrier. As of early 2020, Air New Zealand operated a fleet of approximately 114 aircraft and offered air services to 20 airports in New Zealand as well as 30 destinations internationally. COVID-19 restrictions have severely curtailed international air travel and, as a result, Air New Zealand is currently operating a much smaller fleet.

15. To strengthen and expand its international network, Air New Zealand developed its Pacific Rim strategy, whereby it operates to key hubs and then serves points beyond those hubs, using revenue-share alliance partnerships. Pre-COVID-19, this enabled it to serve major international markets such as China, Singapore, Hong Kong and the United States on a more sustainable basis.

16. Air New Zealand is a member of the Star Alliance group.

17. The New Zealand Government currently owns 52 percent of Air New Zealand shares. The airline is listed on both the New Zealand and Australian Stock Exchanges.

Air China

18. Air China is the national flag carrier of China, and its headquarteres are in Beijing (Beijing Capital International Airport) but has flight operations and a significant distribution network across the whole of China. It is one of China's largest airlines.

19. As at the end of January 2020, Air China operated 453 routes to 187 cities in 43 destinations.

20. Air China joined the Star Alliance group in December 2007.

21. Air China's main shareholders are the China National Aviation Holding Company and China National Aviation Corporation (Group) Limited, both state-owned enterprises. Together they own 51.7 percent of the shares in Air China. The airline is listed on the Hong Kong, London and Shanghai Stock Exchanges.

22. Air China holds shares in certain other carriers, including a 29.99 percent minority stake in Cathay Pacific. Cathay also holds an 18.13 percent minority shareholding in Air China. The main subsidiaries of Air China are Air Macau, Shenzhen Airlines, Dalian Airlines and Beijing Airlines.

The Alliance

Background

23. Before the Alliance, Air New Zealand and Air China cooperated on frequent flyer programs and airport lounge access, and were also party to a code-share agreement under which:

    - Air China code-shared on Air New Zealand's Auckland-Shanghai service and seven trans-Tasman services; and

    - Air New Zealand code-shared on four of Air China's Australia-China services and three domestic services in China.

The 2015 authorisation

24. In March 2015, Air New Zealand and Air China submitted an application under the Act seeking authorisation of a strategic alliance. The Alliance was authorised late 2015 by the Minister of Transport for a period of five years, which is due to expire on 31 March 2021.

25. At the time of the initial application, the Ministry had concerns the Alliance would overlap with the Air New Zealand/Cathay Pacific alliance, and the fares Air New Zealand set on connecting services through its alliances with Cathay Pacific and Air China would be aligned. This would have resulted in higher prices for consumers travelling between New Zealand and other cities in China via Shanghai, Beijing and Hong Kong.

26. There was also the risk, as with any revenue-sharing alliance, that it would constrain growth and competitive pricing on the Auckland–Shanghai and Auckland–Beijing routes.

27. Revenue-sharing alliances commonly attempt to reflect the principle of “metal neutrality”. This broadly means that the airlines will set up the alliance in a way that eliminates any incentives for either party to sell more tickets on their own services. Airlines normally do this by sharing revenue earned on their services equally and by negotiating favourable rates for how they charge each other for carrying passengers.

28. Two airlines co-operating with each other in a revenue-sharing alliance may reduce or eliminate any competition between themselves, which could lead to lower capacity and/or higher airfares on an affected route. However, this does not apply if (pre-alliance) neither airline is able to generate enough feeder traffic on its own network to operate viably on that route (i.e., if there is no competition to be eliminated).

29. Indeed, pre-alliance, Air New Zealand accessed (via codeshare) Air China’s feeder traffic into and beyond Shanghai to justify its direct service between Auckland and Shanghai. For its part, Air China relied on Air New Zealand’s domestic network to generate enough passengers on its services between China and New Zealand, via Australia, with Air New Zealand flying the Australia/New Zealand legs on a codeshare basis. Once the parties formed an alliance, Air New Zealand retained its Auckland/Shanghai route and Air China introduced a direct service between Auckland and Beijing.

30. On both services, the Applicants share revenue and agree on scheduling - which they could not do pre-alliance when they were competing for passengers. Therefore, the alliance between Air New Zealand and Air China saw the introduction of a new direct service between China and New Zealand, rather than the elimination of any overlapping services, and a significant rationalisation of the network.

31. This addressed a concern raised by Wellington Airport regarding the 2015 application, 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.”

32. The view was that Air New Zealand’s more conservative thinking could temper any plans for the more aggressive expansion of capacity by Air China. Nevertheless, we considered the likely reduction in competition would not outweigh the potential benefits of the Alliance, and decided a term of five years provided a sufficient level of certainty and stability to the Applicants to justify their investment in the alliance. That would also allow for the reassessment of the Alliance after an appropriate interval.

The current (2020) application

33. The Applicants are seeking reauthorisation of the Alliance for another five years, until 31 March 2026.

34. The Applicants argue the Ministry's earlier concerns have not materialised. That is, the Alliance has not constrained growth or competitive pricing on the Beijing–Auckland route, and that it has not prevented other direct services commencing from China to New Zealand. They also argue that the Alliance has delivered significant benefits to New Zealand.

35. At the time the parties entered into the Alliance Agreement, the parties expanded the codeshare and SPA (defined in paragraph 8) agreements to include a number of additional routes. During the period of authorisation, the parties further expanded that access by adding [redacted] more routes to their SPA and [redacted] more routes to the Codeshare Agreement. In aggregate, compared to the position prior to authorisation, the parties have now added an additional [redacted] routes to their codeshare agreement and an additional [redacted] routes to their SPA.

36. The outbreak of COVID-19 impacted Alliance services from as early as January 2020. Because of this, the Applicants limited their analysis in the application to an assessment of the historical performance of the Alliance between the dates of December 2015 and December 2019.

37. The Ministry's analysis will account for pre-COVID performance, consider how COVID-19 restrictions may impact the future of the Alliance, and analyse the potential benefits, risks and the uncertainties of reauthorising this Alliance in a COVID-19 environment.

Scope of the Alliance

38. Under the Alliance, the Applicants coordinate their operations between and within New Zealand and China. The Alliance provides for varying levels of cooperation between the airlines on:

    - *'Alliance Sectors'* being sectors operated by either airline directly between New Zealand and China (i.e. Auckland – Shanghai and Auckland – Beijing). Cooperation on direct services between New Zealand and China will include revenue sharing, code sharing and coordination of capacity and pricing.

    - *'Feeder Routes'* comprising domestic services within New Zealand and China which include an Alliance Sector. Cooperation on these services will include code sharing, coordination of pricing, revenue management (but not revenue sharing) and marketing.

39. The Alliance Agreement sets out the principles and objectives that will underlie the establishment and maintenance of cooperation between the Applicants. It also details the markets that are covered and the level of cooperation attached to those markets.

40. In addition, the Alliance is supported by several "Implementing Agreements". These include:

    a) *<u>Codeshare Agreement:</u>* which includes both Alliance Sectors and Feeder Routes, with the number of Feeder Routes increasing over the course of the Alliance;

    b) *<u>SPA:</u>* which provides favourable rates and access to each party's network;

c) *Frequent Flyer Programme Agreement (FFP):* which aligns the parties' FFP programmes; and

d) *Revenue Sharing Agreement:* which sets out the terms on which the parties will allocate revenue generated on the Alliance Sectors.

41. The Applicants have applied for authorisation of the Alliance Agreement (which includes the "Implementing Agreements" above) and the amendments to those agreements. The reauthorisation does not include any changes to the Alliance agreement, but does include some minor changes to the Codeshare, SPA and Revenue Sharing Agreements.

Commercial Rationale for the Alliance

42. The Applicants state that the commercial rationale for this Alliance has not materially changed since the 2015 Application.

Air New Zealand

43. Air New Zealand argues the Alliance continues to provide greater security of its Shanghai services through the support of a strong Chinese carrier. [redacted]

44. Part of the reason for Air New Zealand's difficulty with this service, [redacted]

45. They argue, however, that the structural *dis*advantage faced by Air New Zealand is mitigated by the Alliance, which helps Air New Zealand compete more effectively by leveraging both Air China's sales and distribution network as well as the strength of their stakeholder relationships in China. As a result, the Alliance has been able to maintain passenger volumes on its Shanghai services despite aggressive competition from other Chinese carriers over the course of the Alliance.

46. The application also states that, given the impact of COVID-19, the Alliance will be particularly important as the New Zealand-Chinese tourism industry recovers.

Air China

47. Air China asserts that the reauthorisation of the Alliance will be important as the aviation industry recovers from COVID-19, and that it will guarantee the continued support of Air New Zealand to sustain and grow the Auckland-Beijing service.

48. Air China also claims that, during the period of the authorisation, Air New Zealand supported them by providing: better and cheaper access to its domestic network; sales and marketing support (including Air China ticket sales on flights operated by Air New Zealand); and, [redacted]

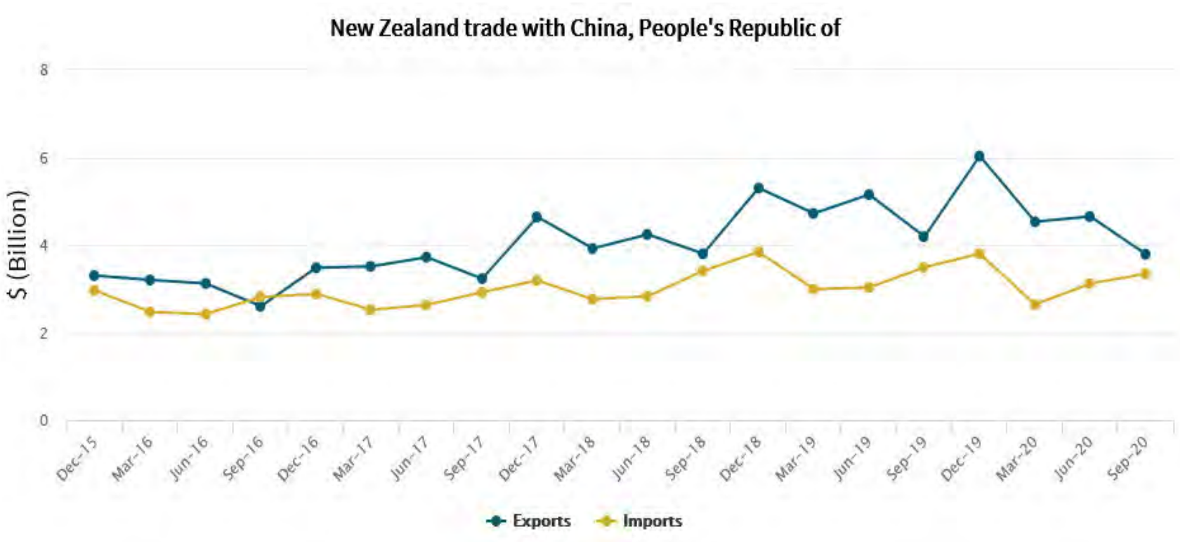
Strategic and economic importance of China for New Zealand

49. Although COVID-19 has affected economies around the world, the trade and business cooperation between China and New Zealand has remained relatively stable.

50. The New Zealand-China Free Trade Agreement (FTA), the first comprehensive FTA between China and an OECD country, entered into force on October 1, 2008. It has since been upgraded to further liberalise and facilitate trade between the two countries across all areas of trading interest to New Zealand. It has formed the foundation of New Zealand's economic trading relationship with China.

51. As a result of the FTA, China has become one of New Zealand's largest sources of trade, and has recently surpassed Australia as New Zealand's number one export destination for goods and services. New Zealand and China have two-way trade (exports and imports of goods and services) exceeding $33 billion. In 2019, New Zealand exports to China were $20.1 billion, comprising $16.7 billion in goods (e.g. dairy and meat products) and $3.4 billion in services (e.g. tourism, education, and transport). Similarly, New Zealand imports from China were $13.3 billion, comprising $12.5 billion in goods and $800 million in services.

Figure 1: *New Zealand trade with China between December 2015 and September 2020 calendar years (source: Stats NZ)*



52. The New Zealand – China tourism market was also growing fast. In the year ended 2019, a total of 415,479 passengers arrived from China, compared with 366,940 in 2015 (see Figure 2 below), and spent around $1.7 billion in New Zealand in 2019 alone.[1]

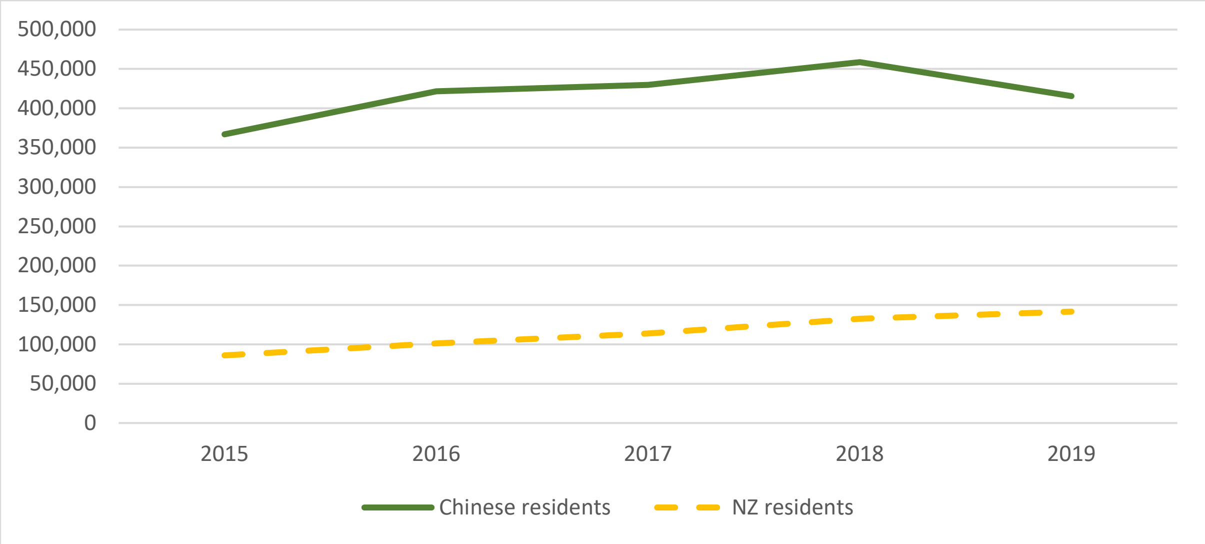
53. With respect to tourism, China had become our second largest market both in terms of arrivals and spend, behind Australia. Prior to COVID-19, the Ministry of Business, Innovation and Employment (MBIE) forecasted that China would have reached and surpassed Australia as the largest contributor to spend by 2024.[2] The future growth in travel between both countries, particularly given the current COVID-19 situation, is

[1] Data from Tourism New Zealand.
[2] Data from Ministry of Business, Innovation and Employment.

strategically and economically important to New Zealand – especially with China's quick recovery from the virus.

54. Figure 2 also shows that the market is primarily dominated by inbound tourists from China, with New Zealand residents only representing a small proportion of passengers travelling between New Zealand and China. For this reason, as in our 2015 report, our analysis primarily focuses on inbound traffic coming from China into New Zealand, particularly on the Alliance routes.

***Figure 2**: Total number of New Zealand residents returning home from China and the total number of Chinese residents flying to New Zealand from December 2015 – 2019 (source: Stats NZ)*



55. Visitor arrivals from China were significantly impacted by COVID-19, showing a decrease from 38,820 arrivals in November 2019 to 176 in November 2020.

56. The economic relationship with China is strategically key for New Zealand, and will be even more valuable as the world recovers from COVID-19.

Consultation

57. We consulted stakeholders on the proposed reauthorisation of the Alliance, between 29 July 2020 and 31 August 2020. Submissions were received from Auckland International Airport; Auckland Tourism Events and Economic Development; Tourism New Zealand; Tourism Industry Aotearoa; and Christchurch International Airport.

Auckland International Airport

58. In its submission, Auckland Airport notes that it supports market structure arrangements that are consistent with fair and balanced competition, and which provide clear benefits for travellers. Auckland Airport has no concerns about this alliance application and believes it will provide additional connectivity and choice to consumers.

59. Auckland Airport also notes the impact of COVID-19 on aviation, and emphasises the Ministry's role in ensuring that the overall outcomes for travellers and the New Zealand public are positive.

Auckland Tourism, Events and Economic Development (ATEED)

60. ATEED strongly endorses the renewal of the Alliance for a further five years. It considers the Alliance supports the ease of travel to New Zealand from important existing and emerging markets and acknowledges China as one of New Zealand's most important trade partners.

61. The submission also noted that the Alliance will play a key role in the economic recovery post-COVID-19. The ease of travel and direct services from international ports, including Beijing and Shanghai to Auckland will stimulate economic growth, create new jobs in our region and raise its profile as a place to visit, study, invest in and do business.

Tourism New Zealand

62. Tourism New Zealand supports the Alliance reauthorisation. It notes the Alliance has contributed to an increase in tourism from China and will be crucial for the re-establishment of air connectivity between New Zealand and China.

63. The submission also notes the Alliance has delivered stability of services to New Zealand in a market where carriers otherwise have to react to demand fluctuation.

Tourism Industry Aotearoa (TIA)

64. Similar to Tourism New Zealand, TIA supports the Alliance reauthorisation emphasising the importance of strong air connections to support New Zealand's COVID-19 recovery, and support the New Zealand Tourism industry's growth framework – Tourism 2025 and Beyond.

65. It cites connectivity as a key theme of the framework, and that the Alliance will facilitate these much-needed connectivity links with one of New Zealand's biggest international markets, China. This will help support the rebuild of international tourism in New Zealand.

Christchurch International Airport Limited (CIAL)

66. CIAL did not provide a view on whether the Alliance should or should not be authorised. However, it did provide a view on the factors that should be taken into consideration in the analysis of the Alliance. It stressed that the Ministry should demonstrate that it has undertaken a rigorous analysis of factors, including the impact of COVID-19 and recent market changes and the cumulative impacts of existing alliances the Applicants are party to, before determining if the Alliance is in the wider public interest.

Legal framework for our analysis

67. Our analysis relating to the proposed reauthorisation of the Alliance includes both an analysis of whether it meets the specific statutory criteria in the Civil Aviation Act, as well as a public interest assessment.

Statutory analysis

68. 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.

69. Section 88(4) of the Act sets out specific statutory criteria that all provisions of all applications must meet in order to be authorised. These are in the form of prohibitions (i.e. an arrangement cannot be authorised if it does specified things).

70. We previously determined that the Alliance and implementing agreements of this Alliance satisfied these criteria. We have reviewed the amended application and have confirmed that the current versions of the agreements (which are largely unchanged) also satisfy these specific criteria and are capable of being authorised.

71. The Act does not require the Minister to authorise an application merely because it passes these statutory tests. Rather, it prescribes that the Minister "may from time to time" specifically authorise them. This indicates that the Minister may exercise discretion in authorising an alliance, having taken into account the relevant considerations set out in the legislation. We also believe that there is a significant public interest analysis that is beneficial to do in these circumstances to inform the Minister's decision.

Public interest analysis

72. In making a decision, any detriment to consumer welfare may be weighed against any special considerations relating to international air carriage in the relevant markets.

73. We have undertaken a comprehensive analysis of the proposed alliance to determine whether authorisation is in New Zealand's best interests. This consists of:

- consideration of what the alliance is likely to mean for services between New Zealand and China during the COVID-19 recovery, compared to the situation where the alliance is not reauthorised
- assessment of whether the alliance delivered the benefits that the Applicants claimed would eventuate in the first four years of the Alliance
- consideration of any risks or detriments that authorisation would entail for New Zealand as a whole

74. Any conclusions or assertions made in this report should be considered against our assessment of the counterfactual (i.e., what would happen if the Alliance were not reauthorised). 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 on page 30 of this report.

75. 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 to authorise an agreement may have on New Zealand's aviation industry and our international connectivity over the long term (particularly in light of COVID-19 conditions) – both of which are indirectly affected by Air New Zealand's success as a business. However, the fact that the New Zealand government owns 52 percent of Air New Zealand is not a consideration in our analysis.

76. As this Application is seeking reauthorisation of an existing alliance (as opposed to authorisation of a new alliance), we have a base of evidence to draw upon. This includes data provided by the Applicants (either in their application or in response to requests we have made for additional information), and other data sources including Statistics New Zealand's International Travel and Migration database, CAPA - Centre for Aviation, and Sabre, a commercial source of airline industry data.

77. Much of our analysis focuses on assessing whether the potential benefits and risks identified in our assessment of the 2015 application have materialised. At a broad level, we expected to see:

- stimulation of demand following Air China commencing the Auckland-Beijing service, including opportunities to deploy more capacity on that service
- improvements to the sustainability of Air New Zealand's Auckland-Shanghai service, including an increase in the numbers of Chinese residents travelling on those services
- increases in passenger numbers between New Zealand and China at least in line with predicted levels of growth
- increased trade between New Zealand and China as exporters take advantage of the capacity offered by the new Auckland-Beijing service.

78. We recognised that other benefits would need to be monitored to test that these have eventuated within the period of authorisation:

- greater competition, in the form of competitive pricing, between Air China and Cathay Pacific for passengers travelling between New Zealand and China
- greater availability of lower fares on alliance services, including for passengers connecting to other cities in China
- increased likelihood that the alliance will commence new direct routes between New Zealand and China, particularly to/from airports outside of Auckland (the airlines have not identified this as a benefit of the alliance but it is plausible that a new direct route could be viable in the next 5 years).

Competition analysis

79. As part of our analysis, we have reviewed how the Alliance likely affects, and will affect, competition in the market for international air services to and from New Zealand, which includes the relevant COVID-19 considerations.

Market definition

80. We have defined the primary market as being the markets mainly affected by scheduling, pricing and capacity coordination under the Alliance. For this application we consider the broad relevant market to be services between China and New Zealand, with a specific focus on the catchment areas around the cities directly connecting the Alliance Routes (Auckland – Shanghai and Auckland – Beijing).

81. As such, the main Chinese markets of focus for the Alliance are:

- the Yangtze River Delta region that comprises the provinces of Shanghai, Jiangsu, Zhejiang and Anhui
- the Jing-Jin-Ji Metropolitan region that includes the provinces Beijing, Tianjin, Hebei (map included in Appendix One).

82. The Alliance also covers domestic feeder services within New Zealand and China respectively (see routes covered in Codeshare and SPA), but it does not cover services beyond China. Nor does the Alliance cover freight services.

Yangtze River Delta

83. The Yangtze River Delta region is centred around the province of Shanghai, and extends across parts of the provinces of Zhejiang, Jiangsu and Anhui. It includes 27 cities, covers 225,065 square kilometres, and represents a total population of 163.3 million people. This region is one of the most densely populated on earth, with Shanghai alone being one of the most populous cities with a population of approximately 27 million as of 2020 and the highest GDP of any city in China.

84. The major cities in the Yangtze River Delta region are interconnected through a dense network of highways and high-speed railways.

    - Hefei city in Anhui is the furthest city from Shanghai with a driving time of 5 hours. However, high-speed rail options take only 2-4 hours (ticket price NZD 31 - 69)
    - Hangzhou city in Zhejiang to Shanghai is a 1h 50m drive, or a 45 minute journey via high speed train (ticket price NZD 15 - 32)
    - Nanjing city in Jiangsu to Shanghai is a 3 hour car ride or a 1 – 3 hour journey on high speed train (ticket price NZD 12 - 50).

85. Last year, China unveiled its plans for the integrated development of the Yangtze River Delta. This includes agreements between the three regions to connect their inter-provincial highways, and proposes a number of new high speed rail projects.

86. Shanghai's Pudong Airport is the eighth-busiest airport in the world by passenger traffic, and the only major international airport that offers flights between New Zealand and the Yangtze River Delta region. As connectivity between the three regions is already highly developed, and travel times continue to get easier and shorter, most people will opt to drive or train to Shanghai Pudong Airport to fly to, or return home from, New Zealand.

Jing-Jin-Ji Metropolitan

87. Jing-Jin-Ji's Metropolitan Region is the provinces of Beijing, Tianjin and Hebei, whose combined population is over 110 million people. The whole region covers over 216,000 square kilometres and accounts for approximately 10 percent of China's total GDP. Beijing, China's capital, is the main hub for Air China and is the third largest city in the world, home to around 20 million residents.

88. The three major cities in the region are interconnected through a network of highways and high-speed railways:

    - Tianjin is just over one hour to Beijing by car and only a 30 minute journey via high-speed rail (with ticket price being NZD 11 -19)
    - Zhangjiakou city in Hebei takes three hours by car to get to Beijing, but only 47 minutes via the new high-speed railway officially opened in December 2019 (with ticket price being NZD 18 – 25)
    - Over 800 major road infrastructure and expressways have been upgraded between the cities, and several new high-speed rail projects have been recently completed, including the extension of the intercity railway between Beijing and Tianjin, the rail between Tianjin and Baoding in Hebei.

89. The region is served by three key airports: Beijing Capital International Airport, Beijing Daxing International, and Tianjin Binhai International Airport. Although Beijing's role as an international air hub is highly valued, Tianjin is one of the major air cargo centres in China and is growing fast. These three major airports are within 150 kilometres of each other and are all striving to expand.

90. Given the proximity of the airports in Beijing and Tianjin to one another, a significant proportion of passengers coming from or going to New Zealand are likely to regard flights arriving in or departing from any of these airports as reasonably substitutable. For this reason, airlines operating flights between New Zealand and the Jing-Jin-Ji region are likely to be constrained in their ability to increase airfares (or reduce capacity) by the existence of competitive offerings from airlines operating from the other airports in the region.

91. Therefore, for the purposes of the competition analysis, the relevant geographic market includes these provinces rather than being confined to Beijing. Flights from the Jing-Jin-Ji region to New Zealand are only offered from Beijing Capital International Airport and Tianjin Binhai International Airport.

92. As connectivity between the three provinces grows, and travel times continue to get easier and shorter, more people will choose to drive or train to Beijing Capital International Airport or Tianjin Binhai International Airport to fly to, or return home from New Zealand.

China – New Zealand

93. The Applicants argue that, over the period of authorisation, there has been a significant increase in competitors' entry and expansion of services between New Zealand and China, including direct and one-stop services. They state that this was primarily driven by the entry of new Chinese carriers (including low cost carriers) commencing direct services to New Zealand from additional ports in China, significant capacity increases particularly by China Southern from Guangzhou, and [redacted]

94. Over the period of authorisation, the New Zealand – China market involved five major Chinese carriers operating direct services to New Zealand, namely Air China, China Eastern, China Southern, Sichuan Airlines, and Hainan Airlines from different Chinese cities. More specifically, we confirm that since the Alliance was authorised:

- China Southern Airlines flew Auckland-Guangzhou 14 times a week all year round, and has commenced a seasonal direct service from Guangzhou to Christchurch in October 2018. Since COVID-19, they have been operating an average of two passenger services a week between Auckland and Guangzhou.

- In 2017, Sichuan Airlines commenced three times a week services between Chengdu and Auckland. They have not operated any flights since the emergence of COVID-19 in early 2020.

- Hainan Airlines commenced services between Shenzhen and Auckland three times a week, and increased capacity on the service from October 2018, in addition to its Auckland-Chongqing services (also three times a week). However, they also have not operated any flights under COVID-19 conditions.

- China Eastern was flying Auckland-Shanghai an average of nine times a week. Since COVID-19, they have been operating an average of two passenger services a week between Auckland and Shanghai.

95. For comparison with the Alliance, it is worth noting that before COVID-19 Air China and Air New Zealand were operating daily services on their respective Auckland-Beijing and Auckland-Shanghai routes. However, under COVID-19 conditions, Air China has stopped operating flights to New Zealand and Air New Zealand has reduced its service to Shanghai to one passenger flight a week.

96. The New Zealand – China market is also contested by indirect (one-stop) competitors including Qantas (via Australia), Cathay Pacific (via Hong Kong) and Singapore Airlines (via Singapore).

97. This growth in competition was supported by an expanded Air Services Agreement between New Zealand and China in March 2017, which increased the weekly limit of passenger services between New Zealand and China from 49 to 59 per week for airlines of each side, with provision to move to 70 services per week.

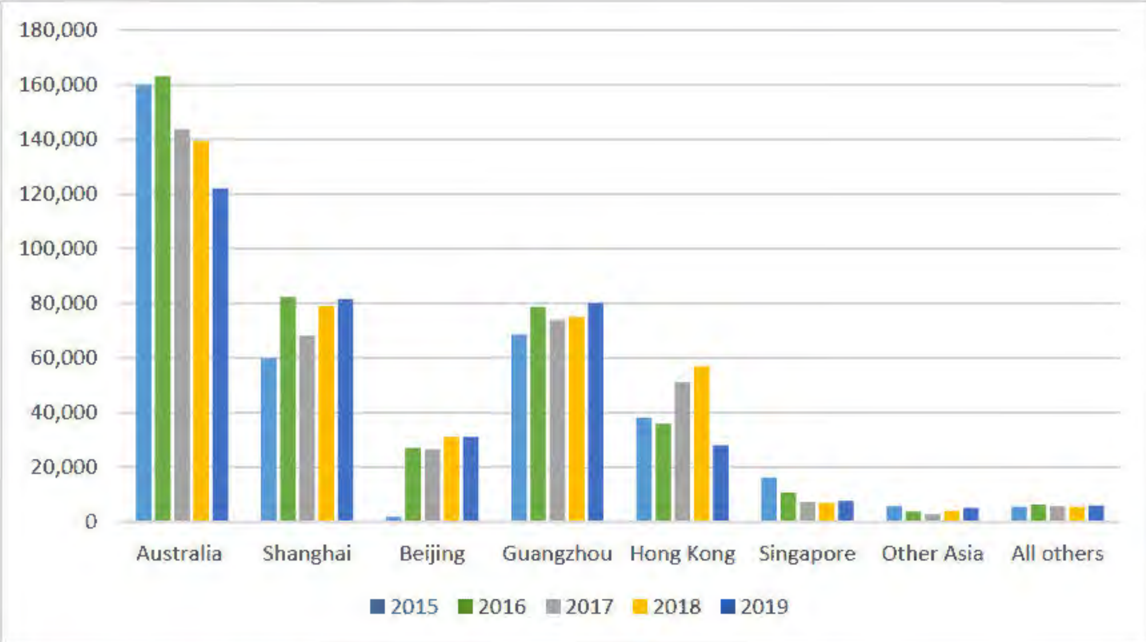
98. Considering the above, the China – New Zealand market dynamics and passenger movements have changed over the period since authorisation.

99. Since its authorisation in 2015, the Alliance has provided attractive one-stop options via Shanghai and Beijing to passengers travelling between China and New Zealand. As shown in Figure 3, more Chinese residents are flying to New Zealand via Beijing and Shanghai, instead of via Australia or Guangzhou:

- the number of Chinese arrivals to New Zealand via Shanghai increased by 36 percent between 2015 (59,808 passengers) and 2019 (81,517 passengers)
- similarly, the number of Chinese arrivals to New Zealand via Beijing slightly increased by 4 percent between 2015 (45,936 passengers) and 2019 (47,795 passengers)
- the number of Chinese arrivals to New Zealand via Guangzhou increased by 17 percent, from 68,544 passengers in 2015 to 80,101 in 2019
- the number of Chinese residents flying to New Zealand via Australia fell by 23 percent, from 159,648 passengers in 2015 to 122,074 in 2019.

100. Air China being the sole direct service provider on the Beijing – Auckland route, and Air New Zealand being one of the two carriers providing direct services on the Shanghai – Auckland route, we can also note that the Alliance has effectively competed with other one-stop service providers over the period of authorisation.

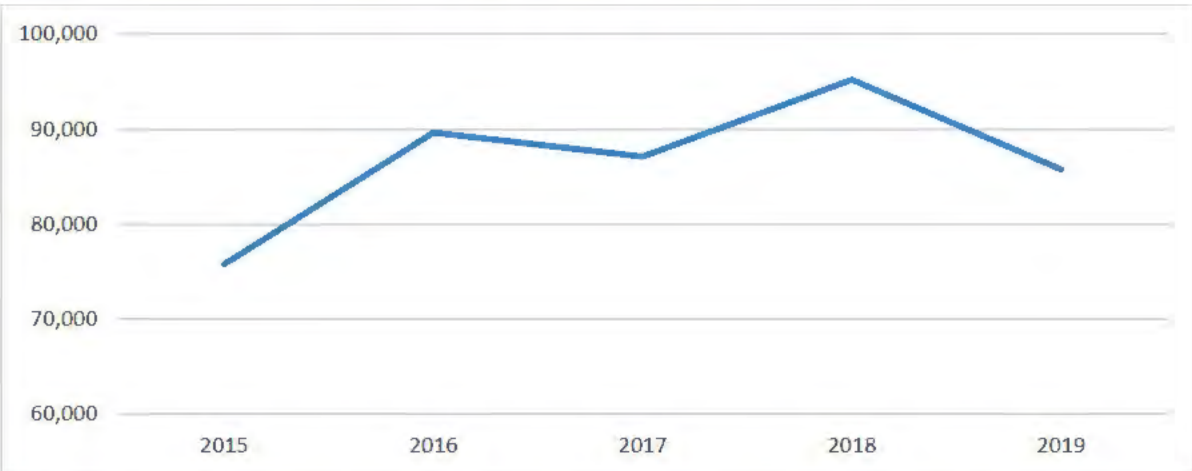
Figure 3: *Chinese resident visitor arrivals from closest overseas port from 2015 – 2019 calendar years (source: Stats NZ)*



Yangtze River Delta – New Zealand

101. Since 2015, passenger numbers on the Yangtze River Delta–New Zealand market have grown steadily (Figure 4). For example, there has been an overall 13.2 percent increase in Chinese visitor arrivals from the wider Yangtze River Delta region (from 75,776 in 2015 to 85,758 in 2019), with arrivals from Shanghai alone increasing 36.3 percent (from 59,808 in 2015 to 81,517 in 2019).

Figure 4: *Total number of visitor arrivals (Chinese residents) from Yangtze River Delta to New Zealand from 2015 – 2019 (calendar years) (source: Stats NZ)*



102. As evidenced below in Figure 5, the Alliance (i.e. combination of Air New Zealand and Air China market shares) is the largest player on the Shanghai – Auckland route. As of 2019, the Alliance held approximately [redacted] share in the market, compared to approximately [redacted] share in 2015.

103. China Eastern's growth over the years has constrained the Alliance and provided direct competition on the route, with a growing market share on the route that increased from approximately [redacted] in 2015 to approximately [redacted] in 2019. This increase is the result of its direct Shanghai - Auckland operation moving to a daily year-round service from 2016.

104. Shanghai is also the main hub for China Eastern. As argued by the Applicants, this means China Eastern can offer a strong service to beyond markets and into mainland China, and uses this beyond network to drive passenger traffic onto its Shanghai service - with approximately [redacted] of passengers on its Auckland – Shanghai service connecting from outside Shanghai. Its status as Shanghai's hub airline gives the airline better access to runway slot times and preferential status when competing for route rights.

105. As a result of this, China Eastern appears to maintain a clear network advantage over the Alliance, despite Air China's sales and distribution network into China, from Shanghai.

106. While the Alliance is the strongest competitor on the Yangtze River Delta–New Zealand market, China Eastern has provided a growing level of direct competition against the Alliance on that route, and has acted as a sufficient constraint on the Alliance. This is reflected in market share changes, where the Alliance's market share dropped as that of China Eastern grew.

107. The Alliance services between Shanghai and Auckland have [redacted]

108. Figure 5 shows that Australian carriers (mainly Qantas) have been able to maintain a market share of approximately [redacted] on the New Zealand – Shanghai route during the period of authorisation. Similarly, Singapore Airlines (via Singapore) and Cathay Pacific (via Hong Kong) have also maintained their shares on the route, although these remained relatively low as shown in Figure 5.

***Figure 5**: New Zealand – Yangtze River Delta: approximate shares by carrier (AKL to/from PVG) (source: NZ Stats and Air NZ data)*

[redacted]

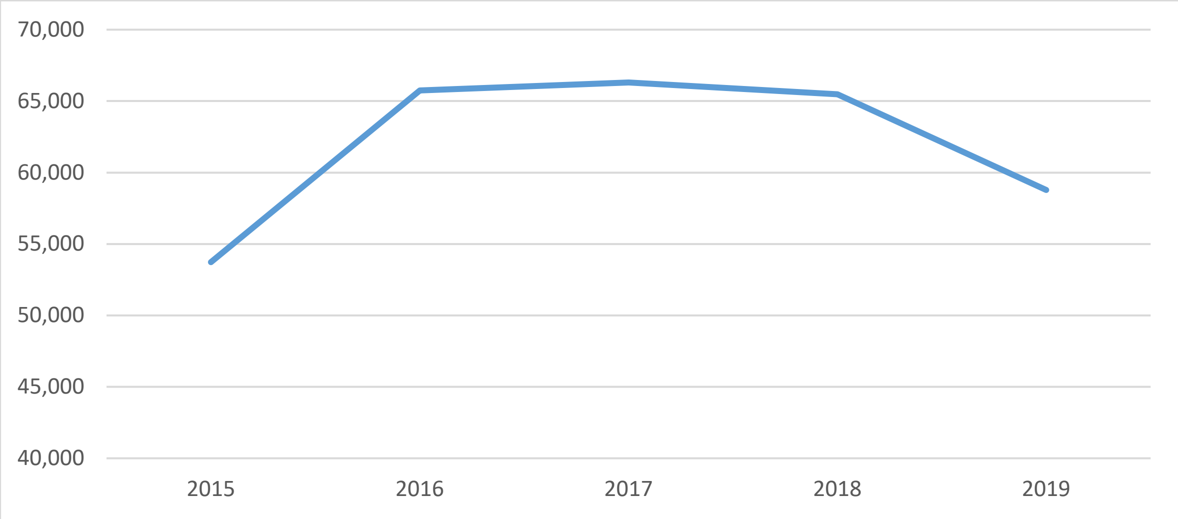
109. Fare pricing is another indicator of competition in the market. We compared samples of airfares from various airlines operating direct and one-stop flights from Auckland to Shanghai, comparing and combining data from different sources where necessary. We note that the fares of Chinese airlines, including Air China, usually track each other fairly closely, with Air New Zealand usually charging higher fares. [redacted] This analysis did not reveal pricing strategies that would have significantly affected customers' welfare or competition. One-stop flights are viable alternatives for customers who may well consider booking those instead of the Alliance services.

110. In conclusion, the competitive dynamic of the New Zealand–Yangtze River Delta region has changed greatly since the initial authorisation of the Alliance, and it is clear that the airlines operating routes between New Zealand and the Yangtze River Delta (via Shanghai Pudong International airport) are competing for passengers. The Applicants appear to have taken appropriate steps to defend their market shares in response to the changing market dynamics, and have not withheld capacity or tried to prevent the entry of other carriers on the route.

Jing-Jin-Ji Metropolitan Region – New Zealand

111. From 2015 to 2019, Chinese visitor arrivals from Jing-Jin-Ji to New Zealand grew by 9.4 percent (from 53,728 passengers in 2015 to 58,782 in 2019) as shown in Figure 6, with a large proportion of this initial growth coinciding with the launch of the Alliance's Beijing service. There was a significant increase of arrivals of Beijing residents alone, that went from 45,936 passengers in 2015 to 47,795 in 2019.

Figure 6: *Total number of visitor arrivals (Chinese residents) from Jing-Jin-Ji to New Zealand from 2015 – 2019 (Stats NZ)*



112. The Alliance has no current direct competitor on the Beijing – Auckland route, and only competes with carriers that provide one-stop services – including China Southern (via Guangzhou), China Eastern (via Shanghai), Hainan (via Shenzhen) and Tasman services (e.g. Qantas via Sydney).

113. Tianjin Airlines was considered a direct competitor to the Alliance after the airline commenced direct services between Tianjin (from Tianjin Binhai International Airport) to Auckland from 2016. However, it exited the route in March 2019, after government subsidies were removed.[3]

114. As evidenced in Figure 7, the Alliance has consistently held the largest share of the Jing-Jin-Ji – New Zealand market over the period of authorisation. As an example, in 2015, the Alliance only held a [redacted] market share, while carriers operating one stop services via Australia held the largest market share at approximately [redacted], followed by China Southern with approximately [redacted]. Since then, Alliance services have grown rapidly. In 2019, the Alliance share rose to approximately [redacted], while carriers operating via Australia saw their market shares fall to [redacted] and China Southern to [redacted].

115. The Applicants argue that given the highly price-sensitive nature of Chinese passengers, these one-stop services provide a significant competitive constraint on the Alliance, and note that [redacted] passengers choose to travel between Beijing and Auckland on indirect services.

116. We accept that one-stop options provide competitive travel options and are viable alternatives for some. In this way, the Applicants still need to compete to secure passengers on their Auckland – Beijing service.

[3] Many local governments of smaller cities offered airlines financial support to open international routes, but such policies failed to make the routes sufficiently profitable and led to these airlines pulling out of those routes when government subsidies were removed.

***Figure 7**: New Zealand – Jing-Jin-Ji: approximate shares by carrier (AKL to/from PEK) (source: Stats NZ and Air NZ data)*

[redacted]

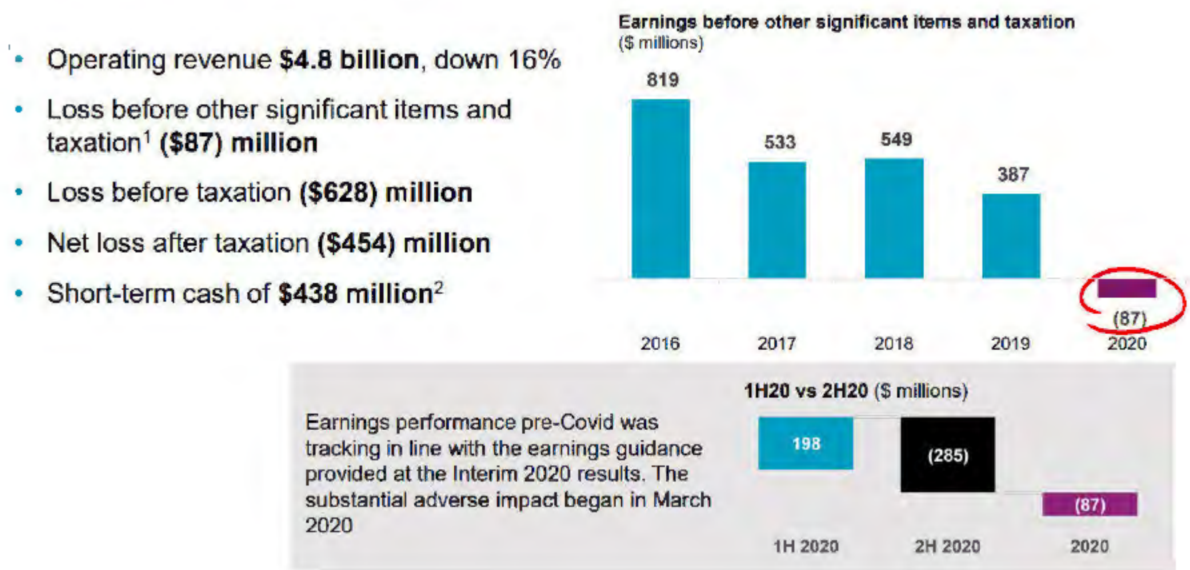
117. As for the Yangtze River Delta – New Zealand market, we compared samples of airfares from various airlines operating direct and one-stop flights from Jing-Jin-Ji region (Beijing Capital International Airport) to New Zealand (Auckland Airport), using different databases over the same periods. This high level analysis did not reveal pricing strategies that would have significantly affected customers' welfare or competition.

118. In conclusion, since the launch of the Auckland – Beijing route in 2015, the Alliance quickly rose to dominate the (non-stop) New Zealand – Jing-Jin-Ji market, with Air China being the only carrier operating on the route. However, the Applicants have faced strong competition from carriers operating one-stop services – especially Chinese carriers and those operating via Australia – which continue to capture a large portion of the market and are able to offer passengers lower fares. These factors provide a sufficient constraint on the Alliance services and we do not consider that the Alliance leads to a lessening of competition in these markets.

Air New Zealand strategic partnerships in the Asia Pacific market

119. The emergence of COVID-19 and consequently the extensive travel and border restrictions in place since March 2020 have had a devastating impact on Air New Zealand's profitability as shown in Figure 8. This resulted in a 74 percent drop in passenger revenue from April to the end of June 2020 compared to the prior year.

Figure 8: *2020 Air New Zealand Financial Summary (source: Air New Zealand - 2020 Annual Results Analyst Presentation)*



120. Air New Zealand has forecasted that [redacted]

Overlaps between Air New Zealand Alliances in Asia Pacific

121. In our 2015 report, we were concerned that there could be some overlap between the three alliances' operations, leading to a lessening of competition. This was mainly due to the airlines involved (i.e. corporate structure, cross ownership and control) as well as the proximity of the alliances' respective networks and operations.

122. Air New Zealand has used each of its Asia Pacific alliances to access different parts of Asia from its partners' hubs that would otherwise be difficult to connect with New Zealand. The three alliances currently operating in the Asia Pacific region are:

- **Singapore Airlines – Air New Zealand** alliance provides access to a number of markets via Singapore, including Europe, South East Asia, India and South Africa. Access to these markets is mainly granted through code-share arrangements included in the alliance agreement between Air New Zealand and Singapore Airlines. This alliance was initially authorised in August 2014 and is currently authorised until 2025.

- **Cathay Pacific – Air New Zealand** alliance focuses on the Pearl River Delta (using Hong Kong as a hub), Southern China, some North Asian countries such as South Korea and Taiwan, as well as Europe (including the United Kingdom). This alliance was initially authorised in November 2012 and was recently re-authorised until October 2024.

- **Air China – Air New Zealand** alliance provides for coordination on non-stop daily flights between Auckland and Shanghai, and non-stop flights from Auckland to Beijing. The focus of this alliance is point-to-point traffic between New Zealand and the large catchment areas of the Yangtze River Delta and Jing-Jin-Ji.

123. Air New Zealand stated that under the Air China – Air New Zealand alliance, [redacted] of Air New Zealand passengers connect onto Air China's network to Southern China. The alliance with Cathay Pacific should be seen as complementary to the alliance with Air China, as the Cathay Pacific network enables Air New Zealand to connect into mainland China, outside the catchment areas of Beijing and Shanghai, and to enter into markets that would otherwise be difficult to reach. Air New Zealand added in its previous application for the Cathay Pacific – Air New Zealand alliance re-authorisation that [redacted]

124. In the 2019 re-authorisation of the Air New Zealand - Cathay Pacific airline alliance report, we concluded that China could effectively be divided into several separate relevant markets, so that having two alliances to cover these markets is appropriate.[4] We still hold that view and this conclusion is not expected to change materially over the next five years.

125. As for the Singapore Airlines – Air New Zealand alliance, [redacted] so as to avoid major overlaps with the other alliances. [redacted] For this reason, we consider the markets are competitive enough to prevent the alliances possessing market power.

126. We conclude that the overlaps between the three alliances do not negatively impact on competition at this stage. Effectively, the three alliances cover relevant markets that are either completely separate or that overlap for such a small subset of passengers that they cannot be regarded as being in the same relevant market. Furthermore these alliances have greatly increased capacity between New Zealand and the rest of the world, and provided more choice to passengers travelling to and from New Zealand.

Public benefits and detriments of the Alliance

127. The Applicants claim that the Alliance has delivered a number of benefits to the New Zealand public. We have summarised these benefits below along with our analysis of the extent to which these can be considered as real public benefits.

Pre COVID Alliance capacity increased over the period of authorisation

128. The Applicants state the overall capacity of Alliance services increased by approximately 8 percent over the period of authorisation.

129. In our 2015 report, we concluded that the launch of the Beijing service would allow for more opportunities to deploy more capacity on that service. Figure 9 confirms some increase in the Alliance capacity on the Auckland – Beijing route from Year 2 of the Alliance (January 2017 – December 2017), mainly in the summer peaks and the Chinese New Year periods. This is in part due to an increase in flight frequency in the seasonal busy periods, and the replacement of Air China A330-200s with Dreamliner 787-9s in 2016.

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[4] Air New Zealand/Cathay Pacific Alliance Reauthorisation 2019

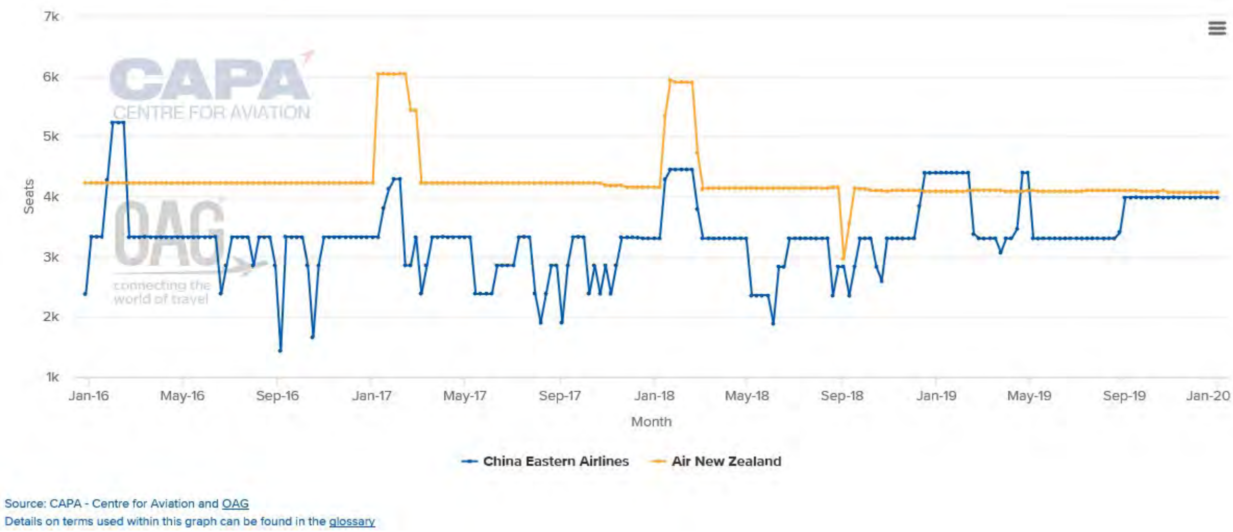
130. We can also confirm that this capacity increase has led to some increase in passenger volumes (mainly inbound Chinese visitors) on this service during the period of reauthorisation, in spite of the existing competition with China Southern and Qantas on the Beijing – Auckland route.

Figure 9: *Airline capacity on Beijing – New Zealand routes (source: CAPA)*

131. With respect to the Shanghai – Auckland route, Air New Zealand has been able to maintain capacity and passenger numbers over the period of authorisation as shown in Figure 10, in spite [redacted]

132. With Air China's support, Air New Zealand managed to secure better slot times at Shanghai airport that are consistent with the departure times of all of its current flights (NZ286) and that will benefit passengers and yield operational efficiencies once Air New Zealand is able to resume flying the route.

Figure 10: *Airline capacity on Shanghai – New Zealand routes (source: CAPA)*



133. Overall, we can confirm that the Alliance has been responsive to market conditions, and acted in a competitive manner when setting capacity on the Alliance routes. We consider that the capacity and passenger volume increases are key public benefits as they have provided more options for consumers, and grown the availability of services to and from New Zealand.

Lower average airfares

134. In our 2015 report, we explained that we would look to test whether the Alliance has been able to offer lower airfares on the Alliance services.

135. The Applicants note the average airfares across all cabin classes on Alliance services have decreased over the course of the Alliance. More specifically, they state that average economy fares have decreased by [redacted] on the Auckland – Shanghai route and by [redacted] on the Beijing – Auckland route.

136. As explained in previous alliance authorisations, a range of external factors influence how airlines, including those operating alliances, set their airfares. These include fluctuations in fuel prices, levels of competition, seasonal traffic, levels of consumer price inflation and exchange rates. It is difficult to reach a firm conclusion as to whether the Alliance has consistently provided for lower average airfares across all fare classes in the markets in which the Alliance operates due to the complexity in airline pricing structures around booking windows.

137. We conducted a monthly comparison of the average airfares (for all travel classes) offered by Air New Zealand and Air China from/to New Zealand and Shanghai/Beijing respectively from 2015 to 2019. We observed that there has been some reduction in average airfares on both routes (for all travel classes) since the beginning of the Alliance period.

138. For example, Figure 11 shows that Air New Zealand's fares on the Shanghai service have steadily decreased from [redacted] in December 2016 to [redacted] in December 2019 (roundtrip). Similarly, Air New Zealand's fares on the Beijing service have decreased from approximately [redacted] in July 2016 to approximately [redacted] in July 2019 (roundtrip).

Figure 11: *Air New Zealand economy fares (incl. taxes) on the Auckland – Shanghai/Beijing routes (round trip) (source: Air NZ data)*

[redacted]

139. Overall, we can conclude that the Alliance has not led to increased airfares and has responded appropriately to market conditions during its period of authorisation.

The Alliance has improved connectivity (but did not access new markets)

140. Alliances usually facilitate greater connectivity between the respective networks of the partners. This includes improved flight schedules, more efficient use of assets, and better connection times on both sides that would not be available otherwise.

141. The Alliance is much narrower in scope than other alliances that have previously been authorised, such as the Singapore Airlines - Air New Zealand and Cathay Pacific – Air New Zealand strategic alliances that have enabled access to secondary and tertiary markets. This Alliance does not include cooperation on services beyond China (e.g. Europe), and remains quite limited for services beyond New Zealand [redacted]

142. In our 2015 report on the first authorisation, we were sceptical about the connectivity benefits of the Alliance, and the ability of the Alliance to commence new direct routes between New Zealand and China. Although this was not identified as a benefit for the Alliance, we thought this could be plausible. However, no new Alliance Sector has been opened during the period of authorisation.

143. The Alliance has however enabled the Applicants to improve their SPA and Codeshare Agreements, and to provide better access to their respective networks. That has resulted in the addition of [redacted] routes to the existing Codeshare Agreement and [redacted] routes to the SPA – [redacted] being operated by Air China and [redacted] by Air New Zealand.

144. For Air China, the Alliance means access (at convenient times and competitive rates) to the Air New Zealand domestic sector beyond Auckland. The Applicants argue that opening the New Zealand domestic network to Air China passengers has stimulated travel to key New Zealand ports, such as [redacted] but also to smaller regional ports such as [redacted] as shown in Table 1. It has raised the total number of passengers to [redacted] in 2019 compared with only [redacted] in 2015.

Table 1: *Air China passengers connecting onto Air New Zealand's domestic network (source: Air NZ data)*

	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

145. For Air New Zealand, the Alliance mainly means access to the catchment areas of Beijing and Shanghai. The Applicants argue that there is also somewhat improved connectivity into mainland China, with an increasing number of Air New Zealand passengers connecting onto Air China services. Although this increase remains relatively small (and was not initially identified as a potential benefit of the Alliance), we agree the expanded Codeshare Agreement and better SPA rates have provided Air New Zealand passengers with better access onto Air China's domestic network.

146. We consider this improved connectivity and better access to the Applicants' respective beyond markets as a public benefit that has been demonstrated by the Applicants.

Optimisation of flight scheduling

147. As set out in their application, the Applicants state they have launched and optimised the Beijing service over the period of authorisation to provide their customers with a better choice of flight times to other parts of New Zealand and China respectively.

148. Air New Zealand further emphasises that, with Air China support, they have gained a greater consistency for departure times from Shanghai by securing better slot times at the airport. This consistency in departure time has reduced the ground time that Air New Zealand's aircraft spend in China, thus resulting in operational efficiencies and cost savings for Air New Zealand. Once services resume post-COVID-19, this will provide their passengers with more convenient and consistent services. [redacted]

149. Overall, we accept the Applicants' claim that optimising flight schedules provides consumer benefits and operational efficiencies.

Stimulation of tourism

150. The Applicants claim that, pre COVID, the Alliance has helped stimulate tourism to New Zealand by contributing to the growth of visitors travelling from/via the Beijing and Shanghai catchment areas.

151. For example, they state that between December 2015 and December 2019, the number of Chinese visitors flying to New Zealand grew by over 18 percent. They claim the Alliance contributed to this growth through the launch of the Beijing service as well as the many sales and marketing campaigns undertaken in China to encourage tourism to New Zealand.

152. While many factors influence tourists in choosing New Zealand as a destination, the increase in total passenger volumes on Alliance services combined with the launch of the Beijing service in the previous alliance authorisation strongly suggests that the Alliance contributed to the stimulation of tourism in New Zealand.

The stimulation of tourism is vital as New Zealand recovers from COVID-19

153. Before COVID-19, international visitors contributed NZD 17.2 billion per year towards New Zealand's economy, making tourism New Zealand's biggest export industry. The

stimulation of New Zealand's tourism will be an important part of the country's overall economic recovery.

154. Considering China is one of our largest sources of visitor revenue in terms of holiday spend[5] and, given the sheer strength, size and continuous growth of the Chinese outbound tourist market[6], restoring tourism demand between China and New Zealand will be particularly important.

155. As explained by the Applicants, the Alliance provides two points of entry for passengers travelling into and from China. It also enables the Applicants to work together with New Zealand and Chinese tourism agencies to aid in the recovery of Chinese tourism to New Zealand and re-establish New Zealand's international connectivity to China.

156. In summary, we agree with the Applicants that the Alliance will be vital as the New Zealand tourism industry seeks to recover from the impact of COVID-19.

Enhanced premium passenger benefits and joint lounge access

157. The Applicants claim the Alliance has realised a number of improvements for Airpoints members and Air China Phoenix Program members as set-out in its 2015 application, including providing members with greater loyalty benefits and the ability to earn and redeem frequent flyer points on either airline's services.

158. According to Air New Zealand, customers flying with them have earned significantly more Airpoint Dollars on travel between New Zealand and China – [redacted] There has also been an increasing number of Air China's frequent flyer base earning and redeeming frequent flyer kilometres on services to New Zealand.

159. Overall, Airpoints members are earning more Airpoints Dollars on services to and via China than they were prior to the Alliance. Eligible Alliance passengers have also continued to benefit from access to each party's respective lounges.

160. While we have considered these benefits as modest in previous alliance applications, the Air New Zealand – Air China Alliance is an exception given the size of the Chinese market. Effectively, Air New Zealand operated services from Shanghai are made available to some of Air China's 50 million strong frequent flyer customer-base.

161. On that basis, we accept that the Alliance provides additional benefits to consumers with respect to loyalty programs and lounge access, hence harmonising the customer's experience.

The Applicants still compete in the airfreight market

162. The Alliance does not provide for the Applicants to coordinate sales in the airfreight market, with cargo revenue being excluded from the definition of Alliance revenues. Therefore Air New Zealand competes with Air China for freight between New Zealand and China. However, since the emergence of COVID-19, Air China has stopped operating flights to New Zealand and thus is not currently competing for freight with Air New Zealand.

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[5] In 2019, Chinese visitors injected a total of NZD 1.7 billion into the economy alone and spent an average of NZD 476 NZD per day (retrieved from Tourism New Zealand).

[6] Prior to Covid-19, China was New Zealand's second-largest international visitor market, comprising 11 percent of total arrivals in 2019. MBIE forecast that arrivals from China would grow by over 50 percent to nearly 700,000 per year by 2025.

163. Overall, airfreight has been relatively steady since 2015 and remains a contributor to the New Zealand – China trade market.

164. Provided the Alliance enables the Applicants to sustain the services in a post COVID-19 world, the ongoing competition between the Applicants in the freight market could be seen as a key benefit as exporters would be able to choose between several providers of airfreight services, including Air New Zealand, Air China, and China Eastern.

165. It is also worth noting that Air New Zealand is part of the International Air Freight Capacity Scheme (IAFC), whereas Air China is not. The main objective of the IAFC is to maintain capacity for critical imports (such as medical supplies) and high value exports through the COVID-19 response and early recovery period. The IAFC scheme is part of the Government's NZD 600 million aviation relief package, which allocated NZD 320 million to provide short term funding support to airlines and other aviation carriers to ensure capacity is provided on key international airfreight routes.

Counterfactual

166. 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.

167. 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

168. In its submission, Air New Zealand notes that if the Alliance is not re-authorised, [redacted]

169. Air New Zealand states [redacted]

170. [redacted]

171. Air New Zealand also references [redacted]

172. [redacted]

Air China

173. Air China explains that prior to the Alliance, [redacted]

174. [redacted]

175. More generally, Air China notes [redacted]

176. Air China states that, [redacted]

Ministry of Transport's assessment

177. Governments worldwide, including both New Zealand and China, have imposed strict border and travel restrictions on international air travel to limit the spread of the COVID-19 pandemic. The dramatic drop in the ability to carry passengers has resulted in many airlines relying on state subsidies to stay afloat, or going bankrupt.

178. The COVID-19-related suspension of international air services will have long-term negative effects on competition in air transport, with likely repercussions on networks and prices. Recently, IATA announced a revised outlook for airline industry performance in 2020 and 2021. While they expect performance to improve over the period forecast, they also predict deep industry losses to continue into 2021.

179. Despite the fact the current market environment is full of reasons for concern, an eventual recovery is expected for the global airline industry with most industry experts expecting demand for air travel to recover within the Alliance's five-year period for which approval is requested.[8]

[7] [redacted]

[8] For example, in July and August, the International Air Transport Association (IATA) and S&P Global Ratings both estimated a return to previous levels of global passenger traffic in 2024.

180. While it is too early to assess with some level of accuracy what would be the medium term impact of COVID-19 on the Alliance services, [redacted]

181. There are a wide range of possible recovery scenarios that would affect the continuation of the Alliance. These scenarios are dependent on many intervening social, political and economic variables (e.g. accessibility of vaccines, ease of travel and border restrictions imposed by states, travel demand) that will determine how, when and the extent to which the aviation industry recovers.

182. As part of our assessment of the counterfactual, we propose the consideration of two high-level, opposing scenarios to illustrate what is possible on both sides of the spectrum.

   i. The current situation continues or worsens. Travel demand and/or airline capacity are considerably reduced in the medium term.

   ii. The current situation improves. Aviation markets return to something close to their previous size and configuration within the next three to four years.

183. Within each of the respective scenarios provided, we have analysed the potential risks and opportunities based on whether or not the Alliance is reauthorised and operational.

Scenario one: The situation continues or worsens

184. In this scenario, the current COVID-19 crisis continues or worsens as infections continue to spread extensively in countries around the world, whether due to failed quarantine rules and lockdowns, lack of successful vaccines, the emergence of new and potentially more deadly and/or contagious variants of the virus or otherwise. Demand or supply for international air travel would continue to be drastically reduced, and New Zealand's border would remain closed beyond the Alliance's term (after the expiry of the reauthorisation)

185. In an attempt to contain the spread of the virus, many governments would likely keep or toughen border and travel restrictions, implement strict quarantine rules and pre-departure testing. As a recent example, in December 2020 countries across the globe suspended travel from the United Kingdom after a mutated variant of the virus was identified in the country.

186. At present, the Alliance services cannot be operated as Air China has suspended all of its international flights to New Zealand. There is very little competition in the relevant markets. Most international airlines have grounded the majority of their fleets due to border closures, poor travel demand or strict passenger quotas in place. If the current situation continues or worsens in the long term, the decision of whether to authorise the Alliance would make little to no difference to market competition considerations.

Scenario two: The current situation improves and COVID-19 is contained

187. In this second scenario, nations are beginning to recover from the pandemic and the virus is contained in most parts of the world. This improvement could be due to effective vaccines being distributed on a wide scale and the introduction of quarantine free zones, which includes the concept of flight bubbles with low risk countries that New Zealand has been considering with both Australia and the Pacific Islands.

188. As a result, national travel and quarantine restrictions would be progressively lifted, borders would be reopened and travel demand would kick in again. This would stimulate

the tourism market and enable increasing and regular passenger movements. We anticipate that there might be a strong demand for travel to a safe, "COVID free" destination – bringing New Zealand to the top of the list of attractive touristic destinations.

189. If the Alliance is reauthorised, many of the public benefits identified in the report would likely be realised. The Alliance would help re-stimulate the China – New Zealand tourism and trade markets (especially Chinese tourists coming to New Zealand) through the redeployment of capacity, and effectively contribute to the recovery of the New Zealand economy. Reauthorisation of the Alliance would provide the Applicants with some level of certainty and the ability to plan services effectively to ensure business viability going forward.

190. At this time, it is very difficult to predict whether Chinese carriers will still be operating in the market and where their strategic focus will be in a post pandemic world. However, the market potential of the Beijing and Shanghai routes to Auckland are large enough to attract several competitors back onto the market.

191. Conversely, the absence of the Alliance in the case of an improved recovery situation [redacted]

192. We believe that, without the Alliance, [redacted]

193. Consequently, [redacted]

194. [redacted]

195. [redacted]

196. While it would be misleading for this report to confidently predict or establish with certainty the future state of the market, consideration of these two scenarios supports our recommendation to reauthorise the Alliance.

197. Overall, we believe that alliances are and will continue to be crucial to help re-establish and maintain global networks, and enable national carriers to compete effectively and survive.

Terms of authorisation

198. The Applicants request reauthorisation of the Alliance until 31 March 2026, i.e. for a further term of five years. They believe that a further period of five years would:

a) enable the parties to support each other in re-building demand and tourism confidence following the outbreak of COVID-19;

b) provide the parties with sufficient certainty to achieve service level improvements; assist with capacity planning; and provide further opportunity for the parties to explore expanded connectivity;

c) improve the competitiveness of the Alliance services with Chinese carriers; and

d) reflect the deepening bilateral trade and tourism relationship between New Zealand and China through sustainable, long term air services to support that relationship.

199. We consider that a five-year term provides a sufficient level of certainty and stability to the Applicants to make long-term investment decisions, particularly under COVID-19 uncertainty, and allows for the reassessment of the Alliance at an appropriate interval.

Conclusion

200. In consideration of the above analysis, and the counterfactual scenario, we believe that on balance, the Alliance delivers benefits to New Zealand that outweigh the potential detriments. In particular, the Alliance will be important as the New Zealand tourism industry seeks to recover from the impact of COVID-19.

201. The Alliance still meets the statutory conditions allowing it to be authorised under section 88 of the Act.

202. On that basis, we recommend that the Alliance be reauthorised for a period of five years, ending 31 March 2026.

Appendix One – Map of China

(Retrieved from http://d-maps.com/carte.php?num_car=11572&lang=en)