

**Application to the Minister of Transport pursuant to Part 9 of the Civil Aviation Act  
1990 for authorisation of the Air New Zealand and Air China Strategic Alliance**

### **Confidential Information**

Air New Zealand Limited (**Air New Zealand**) and Air China Limited (**Air China**) (together, the **Parties**) claim confidentiality for this Application pursuant to section 9(2)(b) of the Official Information Act 1982 (the **Official Information Act**).

A public version will be provided separately. That version will redact information which is confidential to the Parties (the **Confidential Information**).

The Confidential Information is commercially sensitive and valuable information which is confidential to the Parties (*vis-a-vis* the public and also in some respects potentially *vis-a-vis* each other), and disclosure would be likely to unreasonably prejudice the commercial position of one, or both, of the Parties.

The Parties request they be notified of any request made under the Official Information Act for release of the Confidential Information, and that the Minister of Transport (the **Minister**) seeks their views as to whether the Confidential Information remains confidential and commercially sensitive at the time responses to such requests are being considered.

This request for confidentiality is not intended to constrain the Minister and the Ministry of Transport (the **Ministry**) from disclosing information to other Government departments for the purpose of seeking relevant expert advice. However, the Parties request that the Minister ensure any such departments maintain the same full confidentiality as requested above.

The foregoing applies in relation to any material subsequently provided by the Parties which is identified as confidential.

## 1. EXECUTIVE SUMMARY

- 1.1 This is an application for authorisation of an alliance between Air New Zealand and Air China (the **Alliance**).
- 1.2 The Alliance gives rise to a number of benefits, most notably the creation of a new direct service between Beijing (the capital of New Zealand's largest trading partner) and Auckland. Air China's substantial presence in China (e.g. [REDACTED] loyalty members and over [REDACTED] sales reps), coupled with Air China being directly incentivised to sell services to New Zealand will also stimulate tourism from China more generally, and help to support the sustainability of Air New Zealand's existing Auckland – Shanghai route.
- 1.3 There is no direct or indirect overlap of capacity as between the parties: Air China does not operate to New Zealand. This means the alliance does not give rise to any relevant competition impact. In any event, there are a wealth of options for those wishing to travel between New Zealand and China, Auckland and Shanghai (the route on which Air New Zealand operates), and Auckland and Beijing.

## 2. THE ALLIANCE

### The Parties

- 2.1 The parties to the Alliance are Air New Zealand and Air China.

### Air New Zealand

- 2.2 As the Ministry is aware, Air New Zealand is New Zealand's national flag carrier, and offers air services in New Zealand and internationally. Air New Zealand is a member of the Star Alliance.
- 2.3 The New Zealand Government owns approximately 53% of Air New Zealand<sup>1</sup>, with the remainder owned by private investors. Air New Zealand is listed on the New Zealand and Australian stock exchanges.

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<sup>1</sup> Just under 2% is also held by the New Zealand Superannuation fund. See <https://nzx.com/companies/AIR/announcements/244244>.

## **Air China**

- 2.4 Air China is a China based airline offering scheduled passenger services. It is one of China's largest airlines. Its corporate office and main operation base is in Beijing (Beijing Capital International Airport) but it has flight operations and a significant distribution network across the whole of China. It is also a member of the Star Alliance.
- 2.5 As at the end of February 2015, Air China operated 326 routes to 160 cities in 33 countries, utilising a fleet of 366 aircraft.
- 2.6 Air China is listed on the Hong Kong and London stock exchanges. Air China's main shareholders are the China National Aviation Holding Company and China National Aviation Corporation (Group) Limited, both state-owned enterprises. They together own 53.37% of the shares in Air China. For completeness, and as the Ministry is aware, Air China also holds shareholdings in certain other carriers, including a minority stake in Cathay Pacific. Cathay also holds a minority shareholding in Air China.

## **Existing arrangements between Air New Zealand and Air China**

### *Star Alliance*

- 2.7 Star Alliance is the leading global airline network. It was established in 1997, and currently has 27 members. Star Alliance provides customers of its member airlines with access to a worldwide route network, and allows frequent flyers of any member airline to earn and use frequent flyer points and access benefits across the range of Star Alliance partners.

### *Codeshare agreement*

- 2.8 Air New Zealand and Air China are parties to a codeshare agreement under which:
- (a) Air China places its code on Air New Zealand's Auckland – Shanghai service and seven trans-Tasman services; and
  - (b) Air New Zealand places its code on four of Air China's Australia – China services and three Chinese domestic sectors.

### Authorisation sought

- 2.9 The Parties seek authorisation under section 88(2) of the Civil Aviation Act 1990 (the **Act**) to make and give effect to the Strategic Alliance Agreement dated 23 March 2015 (**SAA**) and a number of “**Implementing Agreements**”. As set out in further detail in section 6, the Alliance does not breach any of the provisions in section 88 of the Act which limit the Minister’s discretion to grant an authorisation.
- 2.10 Consistent with previous alliance applications by Air New Zealand, the Parties do not seek authorisation from the Minister for the provisions relating to joint procurement/purchasing, referred to in clauses 3.3(o) and 4.1(a)(v) of the SAA.
- 2.11 The sections below outline why the Minister should exercise his discretion to approve the Alliance, and in particular why the SAA and its Implementing Agreements give rise to a range of benefits to the travelling public, and the New Zealand public generally, that outweigh any potential detriment arising from the SAA.

### The Alliance Agreement

- 2.12 On 21 November 2014 Air China and Air New Zealand signed a letter of intent as part of President Xi’s visit to New Zealand. The Parties have now executed the **enclosed** SAA, which is subject to regulatory approvals.
- 2.13 The Parties have determined that there are significant consumer and economic benefits and efficiencies that can be achieved through close and long-term commercial cooperation. In particular, the Alliance will create new and sustainable long-term services between New Zealand and China.
- 2.14 The Parties intend to cooperate on their passenger services on:
- (a) the “**Alliance Sectors**” operating directly between China and New Zealand, being Air New Zealand’s Auckland – Shanghai service and a new Auckland – Beijing service to be operated by Air China; and
  - (b) the “**Alliance Routes**”, which comprise services within New Zealand and China which include an Alliance Sector.

*Alliance principles and objectives*

- 2.15 The Parties have agreed certain principles and objectives that will underlie the establishment and maintenance of the Alliance, and will be used as a reference point to resolve any conflict of interpretation in relation to the SAA.
- 2.16 The key objectives of the Alliance are to secure the sustainability of the current year-round daily Auckland – Shanghai service operated by Air New Zealand, and to allow for the introduction of a new Auckland – Beijing direct service, the fourth direct route between China and New Zealand. As discussed further below, no airline has operated a direct scheduled service between New Zealand and Beijing since Air New Zealand's suspension of the route in June 2012.
- 2.17 Other Alliance objectives reflect the benefits that the Parties expect to arise from the Alliance. These include:
- (a) over time, and subject to the success of the Alliance Sectors, increasing capacity or adding further Alliance Sectors;
  - (b) providing consumers with an improved service offering, through the harmonisation of service standards and sales policies, a wider choice of journey options, better transfers between flights and connection times, improved disrupt recovery times, and enhanced frequent flyer and premium customer benefits;
  - (c) sharing experience and expertise in relation to each carrier's home market in order to ensure that customers receive the best possible experience on each of the Applicant's services;
  - (d) achieving efficiencies through better load factors and investigating other operational efficiencies in order to reduce overall operating costs;
  - (e) improved revenue as a result of providing a more appealing service and thereby attracting additional passengers to the Parties' services; and
  - (f) ultimately, an increase in competition between carriers on routes between China and New Zealand.
- 2.18 The Parties shall use reasonable endeavours to identify cost saving or joint purchasing opportunities for the Alliance, including exploring the specific matters set out in clause 4.8 of the SAA.

*Summary of cooperation*

2.19 In order to achieve the Alliance objectives, the SAA provides for varying levels of coordination between the Parties in relation to the Alliance Sectors and the Alliance Routes:

- (a) in relation to services operated on the Alliance Routes:
  - (i) joint pricing and coordinated revenue management;
  - (ii) joint sales and marketing;
  - (iii) to the extent practical, optimising connection requirements for domestic sectors of Alliance Routes to maximise performance of the Alliance;
  - (iv) aligning frequent flyer programs and premium customer handling (including lounge access); and
  - (v) joint procurement as deemed necessary and appropriate; and
  
- (b) in relation to services operated on the Alliance Sectors, all of the coordination noted above as well as:
  - (i) revenue sharing;
  - (ii) network planning;
  - (iii) coordinating operational requirements;
  - (iv) aligning airport operations; and
  - (v) to the extent practical, harmonising the customer experience.<sup>2</sup>

*Implementing agreements*

2.20 The Alliance involves a number of Implementing Agreements, which are required to be consistent with the terms of the SAA as far as reasonably possible. The SAA requires

[REDACTED]

[REDACTED]

. These agreements

include:

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<sup>2</sup> See clause 4 of the SAA.

- (a) a “**Code Share Agreement**” to expand the Parties’ existing codeshare arrangements and which will set out the operational arrangements as between the Parties on the Alliance Routes;
- (b) a “**Revenue Sharing Agreement**” to set out the terms on which the Parties will allocate revenue gathered on the Alliance Sectors;
- (c) a “**Special Prorate Agreement**” (“**SPA**”) to enhance the Parties’ existing special prorate agreement, and which will set proportional rates, or “prorates” on such routes as the Parties may agree;
- (d) a “**Premium Customer Handling and Lounge Agreement**” to enhance the Parties’ existing arrangements pursuant to Star Alliance minimum requirements to provide reciprocal premium handling, including lounge access to the extent practical; and
- (e) an “**FFP Agreement**” to enhance the Parties’ existing frequent flyer programme agreement to the extent practical.

*Term of Alliance*

- 2.21 The initial term for the Alliance is five years (ten IATA scheduling seasons). The Parties consider that five years is necessary in order to realise the benefits of the Alliance. The successful implementation of the Alliance, and in particular the launch of the Parties’ Auckland – Beijing service, requires significant investment, including setting up the necessary infrastructure for Air China operations and sales in New Zealand.
- 2.22 For Air China, the security of a five year term provides a substantially better platform to justify this significant investment, and the substantial risk involved in opening a new long-haul service into a destination where it has no existing operations.
- 2.23 In the Parties’ view, the reservations which led to shorter initial terms in relation to certain other alliances (e.g. market share aggregation) do not apply in respect of the SAA, and accordingly the Parties do not believe those decisions should be seen as having a ‘precedent’ value when considering the term for this proposed Alliance.
- 2.24 In summary, given the absence of any meaningful competitive overlap and hence detriment, the introduction of an entirely new service, and the fact the Alliance is also directed at ensuring Air New Zealand has a longer term sustainable position in relation to China, the Parties believe a five year term is warranted.

*Commercial rationale*

2.25 The core rationale for the Alliance is to utilise the strength of each carrier in its respective home market to provide for sustainable air services between New Zealand and China, and in particular to allow for the introduction of a new service between Beijing and Auckland.

2.26 The Parties are confident that the Alliance will attract more inbound and outbound passengers between China and New Zealand through:

- (a) combining each party's distribution and sales strength to allow for sustainable entry on the Auckland – Beijing service and to grow traffic (including better quality traffic) on the Auckland – Shanghai service; and
- (b) combining services between the Parties with expanded code sharing that will provide consumers with a greater network, with more connecting options for behind and beyond markets.

2.27 In addition to the obvious benefit of facilitating the commencement of an Auckland – Beijing service, for Air New Zealand the Alliance will provide greater security for Air New Zealand's Auckland – Shanghai service. [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]. China Eastern has recently confirmed that it will also operate in the Winter 2015/16 seasons, commencing its seasonal services at the earlier date of 4 October 2015.

2.28 [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED].

2.29 The inbound nature of the China – New Zealand market means that the presence of the Alliance is highly unlikely to discourage other Chinese domiciled carriers from serving it, evidenced by the fact that on 30 January 2015 China Southern signalled its intention to commence a Guangzhou – Christchurch service within two years, post the announcement of the Air China and Air New Zealand MOU. Even more recently

(February 2015) it has announced the extension of its seasonal double daily Guangzhou – Auckland service to a year round service (utilising a Boeing Dreamliner).

2.30 The Alliance is consistent with Air New Zealand's Pacific Rim strategy. [REDACTED]  
[REDACTED]  
[REDACTED].  
The focus on Beijing and Shanghai as primarily point to point services is a key reason why [REDACTED]  
[REDACTED].

2.31 For Air China, the Alliance provides an opportunity to enter into the New Zealand market, as part of a sustainable alliance structure, in circumstances where the China-Australasia market is extremely competitive. Air China views the Alliance Routes as key gateways connecting its China domestic network into the China – New Zealand market, competing with other gateways created by China Eastern (Shanghai) and China Southern (Guangzhou), as well as Cathay Pacific (Hong Kong).

2.32 The Alliance structure will provide Air New Zealand with an incentive to feed traffic onto Air China's new Auckland – Beijing service and provide Air China with access to Air New Zealand's domestic network for its inbound passengers. 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 route already served by many carriers, including two flying direct between the two cities.

**SAA is conditional upon authorisation**

2.33 The implementation and ongoing conduct of the Alliance under the SAA is conditional upon obtaining all necessary regulatory approvals to the satisfaction of the Parties, including obtaining authorisation to implement the SAA (and to the extent necessary, the Implementing Agreements) from the Minister.

**Competitive position absent the Alliance**

2.34 If the Alliance was not authorised:

(a) [REDACTED]  
[REDACTED]

[Redacted text]

- (b) [Redacted text]

- (c) [Redacted text]

**3. BACKGROUND – AIR SERVICES TO CHINA**

3.1 As the Ministry will be aware, China is New Zealand's fastest growing market from both a trade and tourism perspective. China is currently New Zealand's second largest inbound market behind Australia, with China – New Zealand traffic doubling from 2009 to 2013, driven largely by inbound leisure. Factors behind this increase include China's continued economic strength and its growing middle class.

3.2 China is now New Zealand's largest export market, the value of exports exceeding NZ\$13 billion for the year ended September 2014, up from \$4 billion for the year ended September 2009<sup>3</sup> and is an increasingly important source of investment. Air services access to China is a key facilitator of these trade relationships, and as the Ministry is aware, the permitted frequencies under the relevant ASA have recently doubled from 21 to 42 a week. The new services made possible by the Alliance will assist to further deepen the trade ties between the countries and are therefore consistent with the underlying rationale for the changes to the ASA.

3.3 However, the market for travel between New Zealand and China is strongly inbound to New Zealand. In the year to December 2014, 264,864 Chinese travellers<sup>4</sup> arrived in New Zealand. In the same period, only 76,860 New Zealanders travelled to China, making China one of New Zealand's most heavily weighed inbound destinations

<sup>3</sup> Source: Statistics New Zealand.

<sup>4</sup> Source: Statistics New Zealand. Includes those visiting New Zealand only, and those also visiting other countries (e.g. Australia) on the same trip.

(inbound being almost 3.5x outbound). This dependence on inbound traffic [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED].

**4. CONSUMER BENEFITS**

**Immediate creation of a new Auckland – Beijing service**

4.1 Air New Zealand launched twice-weekly return services between Auckland and Beijing in July 2008, but withdrew the service in June 2012 [REDACTED]  
[REDACTED].

4.2 [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED].

4.3 Conversely, under the Alliance, the Parties will be able to leverage each other's strengths at their respective ends of the route to operate a year round direct Auckland – Beijing service.

4.4 In terms of the Parties' respective strengths, Air New Zealand is well known and regarded in and around New Zealand and the Pacific Islands. It has a well-developed domestic network on which to carry tourists.

4.5 Air China has a substantial presence in China, including in Beijing.

(a) Fenghuang Zhiyin ("Phoenix Miles") is Air China's loyalty program. Launched in 1994, it has more than [REDACTED] members. Fenghuang Zhiyin currently has [REDACTED] cooperative airline partners, including [REDACTED] Star Alliance members. It also has [REDACTED] non-airline partners, including [REDACTED] categories such as credit card, hotel, bank, telecommunication, car rental, hotel reservation, insurance, restaurant, tourism, health care, retail and online shopping.

- (b) Air China has [REDACTED] sales units and [REDACTED] sales staff, including [REDACTED] sales staff in Beijing alone, and [REDACTED] sales staff in Shanghai. This on-the-ground presence is critical, given the vast majority of its international sales are made by incentivised sales staff. Air China has a strong business department, which focuses on the marketing plan, marketing supervision, marketing administration and marketing evaluation. It has operations departments in different cities to take charge of marketing strategy and business development.
- (c) Finally, Air China's call centre – which is in charge of service and sales – has around [REDACTED] operators.

4.6 The new Auckland – Beijing service (expected to operate from around December 2015) is a substantial benefit to New Zealand. It will increase the attractiveness of New Zealand as a destination (Beijing-based tourists currently have to travel on one-stop services), and the wider Alliance arrangements will directly incentivise Air China to promote New Zealand as a destination – a further substantial benefit to New Zealand.

4.7 Exporters will also benefit from a direct service to Beijing – especially those shipping highly time-sensitive freight. A direct air link to Beijing – the capital of our largest trading partner – is also valued more broadly at a general commercial/trade level.

[REDACTED]

4.8 [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED].

4.9 The Alliance with Air China [REDACTED]. Air China's reach in China is very impressive not only in the main cities such as Shanghai and Beijing but also in second and third tier cities. Prior to the Alliance, Air China has little incentive to promote New Zealand as a destination over other destinations it served directly (e.g. Australia). However, under the Alliance, Air China is financially incentivised to sell the Shanghai – Auckland direct services, and New Zealand more generally as a destination.

4.10 [REDACTED]  
[REDACTED].

- 4.11 This [REDACTED] in turn benefits New Zealand travellers wishing to travel to points in and around Shanghai or to visit Shanghai as part of a wider trip to China. It also benefits the New Zealand tourism sector on account of Chinese residents in that catchment having a convenient service to New Zealand, as well as Chinese residents flying onestop to New Zealand through Shanghai, who now have an online Air China service.

#### **Opportunities for New Zealand suppliers**

- 4.12 The Parties will also look to achieve additional operational efficiencies, e.g. in relation to ground handling, catering, etc.
- 4.13 Quite apart from any benefits from working together, the new Auckland – Beijing service which flows from the Alliance will itself give rise to benefits in terms of the opportunities it creates for New Zealand suppliers to service and support those new aircraft movements (in addition to the benefits which flow to suppliers in the tourism industry as a result of additional tourists).
- 4.14 For instance, Air China will need to recruit new employees, and negotiate for the provision of various services including passenger and freight station sites, aircraft maintenance, navigation matters, catering, refuelling, oil supply, etc.

#### **Premium customer handling, lounge and FFP benefits**

- 4.15 Pursuant to the SAA, the Parties shall enter into an agreement to enhance their existing agreement(s) to provide reciprocal premium customer handling arrangements including by extending to each other the use of airport lounge facilities for qualifying passengers in each of China and New Zealand. The resulting customer benefits will exceed those which would otherwise be available.
- 4.16 The additional “NZ” and “CA” services made possible by the Alliance, e.g. Auckland – Beijing, will in turn increase the value of Air New Zealand Airpoints dollars and Air China FFP points because they represent additional services on which to both earn and redeem those frequent flyer points/loyalty points.

#### **Greater online connectivity**

- 4.17 Air New Zealand will place its code on a number of domestic Air China services. While this connectivity benefit does not loom as large as it does in many other alliances, it is a benefit to New Zealanders wishing to travel to those beyond destinations, and also

makes a journey to New Zealand a more seamless (and hence appealing) experience for those Chinese tourists behind Beijing and Shanghai contemplating an overseas trip.

- 4.18 In addition, the Alliance also involves a new Special Prorate Agreement, pursuant to which each Party will be able to access better rates and inventory availability. This will in turn allow, for example, Air China to make itineraries involving domestic New Zealand sectors more attractive to China-based passengers.
- 4.19 Finally, under the Alliance, both Parties are motivated to promote New Zealand as a destination. To the extent Chinese-based tourists nevertheless wish to visit Australia, then the Parties can offer an appealing triangular / “dual destination” itinerary on either an NZ or CA code.

#### **Competition with other carriers**

- 4.20 The enhanced offering under the Alliance will allow the Parties to better compete with other carriers on routes between China and New Zealand. For instance:
- (a) the direct Auckland – Beijing service is likely to draw traffic away from indirect services (e.g. operated by QF); and
  - (b) more generally, the Alliance will allow the Parties to better compete with other (fast growing) Chinese carriers,

all of which in turn is likely to trigger a competitive response from those carriers to defend their position – to the benefit of the travelling public.

#### **Stimulation of tourism**

- 4.21 The Alliance will provide an incentive for both Air New Zealand and Air China to increase marketing activity to further promote New Zealand as an international destination. The most obvious driver for this increase in tourism is the significant new capacity that the Alliance will introduce in the form of the Beijing – Auckland service. The need to fill this new capacity will stimulate marketing initiatives at both ends of the route.
- 4.22 The potential tourism uplift is substantial, when one considers the sheer scale of Air China's presence in China (■■■■■ loyalty customers, ■■■ sales units, ■■■■ sales staff, etc.) and the resulting volume of passenger traffic that such a presence can drive to services which Air China is now directly incentivised to sell.

4.23 Given the high proportion of inbound leisure traffic on New Zealand – China services, the increase in tourism numbers for New Zealand from this new service is likely to be proportionately greater than it would be on a service which was less reliant on inbound tourists.

4.24 More particularly, the much greater promotion of New Zealand as a destination in China is expected to stimulate an increase in ‘mono’ tourism, i.e. travellers travelling only to New Zealand. The reason this is relevant is because mono tourists tend to stay longer and spend more as a result.

**5. COMPETITION CONSIDERATIONS**

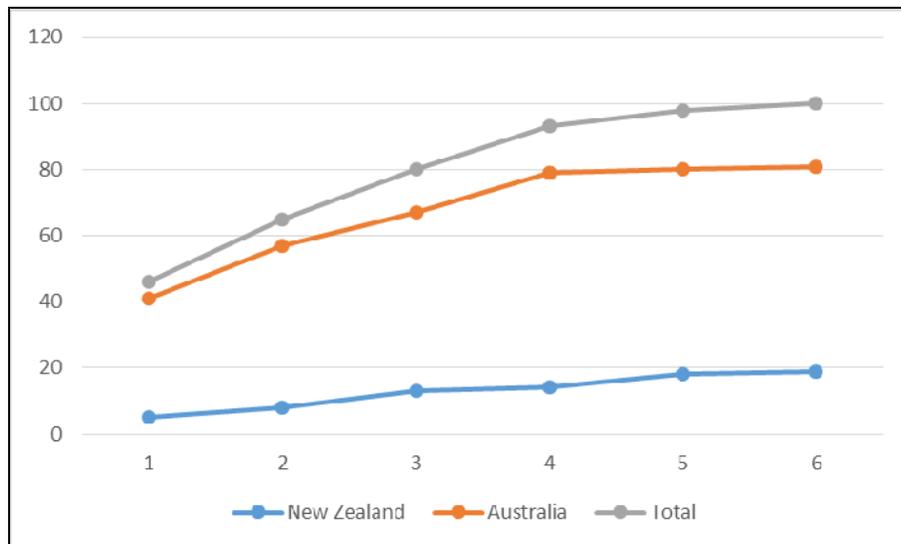
5.1 The Parties do not operate direct flights on the same routes. In fact, Air China does not offer direct or indirect services between New Zealand and China.

5.2 Nevertheless, we set out below a brief analysis of competition between carriers on routes between China – New Zealand, and also specifically on each of the Auckland – Shanghai and Auckland – Beijing routes.

**New Zealand – China**

5.3 There has been a substantial increase in the number of frequencies offered between China and Australia, and New Zealand, in the past six years.

**Figure 1 China – New Zealand/Australia frequencies (Average frequencies per week for the year ended December)**



- 5.4 As Figure 1 shows, total frequencies between Australasia and China have grown from an average of 46 per week in 2010 (5 to New Zealand, 41 to Australia) to 100 in 2014 (19 to New Zealand, 81 to Australia). Despite the significant increase in total frequencies, the number of frequencies operated by the Parties has not changed significantly in that period:
- (a) the number of Air New Zealand direct services to China remained relatively static in this period, rising from 5 services in December 2010 (2 to Shanghai and 3 to Beijing) to 7 in December 2014; and
  - (b) the average weekly frequencies flown by Air China to Australia has risen from 12 in 2010 to 14 in December 2014 (across Melbourne – Shanghai, Sydney – Beijing and Sydney – Shanghai).
- 5.5 Most of the increase in frequencies has been caused by the growth of Chinese carriers other than Air China:
- (a) China Southern has increased frequencies from 12 in 2010 (none to New Zealand) to 44 in 2014 (including 11 frequencies on Auckland – Guangzhou) and they are reported to be aiming for 55.<sup>5</sup> Indeed, more recently they have announced year round double daily services from August 2015, utilising a Boeing 787 “Dreamliner” aircraft;
  - (b) China Eastern has increased frequencies to Australia from 9 in 2010 to 21 in 2014. It has also recently launched a new Auckland – Shanghai service, with four services a week in December, moving to seven flights per week for January through March 2015 (and has recently announced an extended season for Northern Winter 15/16); and
  - (c) Sichuan Airlines launched two services between Australia and China in 2013, and now operates five services per week (three on Melbourne - Chengdu and Sydney – Chongqing).
- 5.6 In terms of market shares, the absence of any direct or indirect capacity overlap means market shares serve more of an illustrative purpose in this case than they may have in other cases.
- 5.7 However, in order to highlight the various carriers which operate direct and indirect flights between New Zealand and China, we have set out in the following tables the

<sup>5</sup> <http://centreforaviation.com/analysis/china-southern-airlines-nearing-target-of-55x-flights-to-australia-continuing-international-push-213091>.

number of *frequencies* offered by carriers operating direct or indirect (one-stop) services to China via Australia or Asian hubs. Necessarily, various assumptions have been made in relation to indirect services in order to make the analysis both illustrative and manageable, but the Parties believe those are appropriate given its purpose.<sup>6</sup>

**Table 1 Frequency share for all China – New Zealand traffic**

All flights share (direct and online one-stop)	Total CHN
Qantas	28%
Singapore Airlines	21%
China Southern	13%
Cathay Pacific	10%
Air New Zealand	8%
Malaysian Airlines	8%
Korean Airlines	5%
Thai Airways	5%
China Eastern	2%

- 5.8 The table illustrates the large number of carriers operating on sectors between New Zealand and China.
- 5.9 As the data shows, Qantas has the greatest number of frequencies, albeit on an indirect basis, which is a function of its multiple trans-Tasman services and various Australia-China operations.
- 5.10 If only direct services are measured the largest carrier (frequency) is China Southern, with a 56% share of frequencies, followed by Air New Zealand (34%) and China Eastern (10%).
- 5.11 Air China does not operate direct or indirect services between New Zealand and China. (Technically, Air China can ticket a customer China – New Zealand and vice versa (e.g. utilising an interline or codeshare on the Tasman), but even then it accounts for a tiny percentage of total traffic<sup>7</sup> ( [REDACTED] )

### **New Zealand – Shanghai**

- 5.12 Air New Zealand introduced its direct Auckland – Shanghai route in November 2006. Commencing as three services per week, it moved to four services a week in

<sup>6</sup> Indirect services comprise flights to/from New Zealand via Australia and Asian hubs. The frequency attributed to a carrier is the minimum of either: (a) the number of frequencies between New Zealand and the relevant hub; and (b) the number of frequencies between the hub and China. For example, if Thai has one Auckland-Bangkok flight per day and four Bangkok-China flights per day that is simply counted as **one** Thai frequency. This approach will ignore any impact of aircraft size, connection times, etc. and so obviously will not precisely measure the relative attractiveness of various indirect alternatives. The same approach has been adopted in the other frequency tables below.

<sup>7</sup> Applying a maximum 12 hour stop-over for the purposes of measuring indirect traffic.

December 2011, and then to a daily service in January 2013. [REDACTED]  
 [REDACTED]  
 [REDACTED]

5.13 China Eastern operates a direct service, and has recently announced plans to increase its capacity on the route.

5.14 As the Ministry will be aware, Air China does not currently operate direct or indirect services between Auckland and Shanghai. [REDACTED]  
 [REDACTED]  
 [REDACTED]  
 [REDACTED]  
 [REDACTED]

5.15 Frequencies ex New Zealand to Shanghai are as follows.

**Table 2 Frequency share for all New Zealand – Shanghai traffic**

All flights share (direct and online one-stop)	Shanghai
Qantas	28%
Singapore Airlines	21%
China Southern	13%
Cathay Pacific	10%
Malaysian Airlines	8%
Air New Zealand	8%
Korean Airlines	5%
Thai Airways	5%
China Eastern	2%

5.16 Qantas is currently applying for regulatory approval for an alliance with China Eastern, which (if approved) will strengthen their services between Australia and China.<sup>8</sup>

5.17 As the table shows, Air New Zealand accounts for only 8% of total (direct and indirect) frequencies.

5.18 Limiting the analysis to direct frequencies only shows Air New Zealand has a 77% share with China Eastern having 23%. Air New Zealand's share is forecast to fall further in the year to March 2016 on account of China Eastern capacity growth, when the split is forecast to become 72% / 28%.

<sup>8</sup> See <http://registers.accc.gov.au/content/index.phtml/itemId/1182892/fromItemId/278039>

### New Zealand – Beijing

5.19 There is currently no direct service operated between Auckland and Beijing. However, a number of carriers provide indirect services, through a number of gateways.

**Table 3 Frequency share for all New Zealand – Beijing traffic**

Online one-stop frequency share	PEK
Singapore Airlines	33%
China Southern	21%
Cathay Pacific	16%
Malaysian Airlines	12%
Korean Airlines	9%
Thai Airways	7%
China Eastern	3%

#### *Recent entry and expansion*

5.20 There has been substantial entry and expansion by Chinese carriers into Australia and New Zealand in the past 5 years. Conversely, Air New Zealand has exited a route and limited its China presence to Shanghai as it looks for a way to sustainably compete on a route heavily skewed towards inbound passengers, who are generally inclined to fly on a Chinese carrier.

5.21 The Parties expect the New Zealand – China market will continue to grow and that competition on it will continue to intensify. Recent history supports this view, as does the intensifying competition between China and Australia, part of which may have been driven by a desire to utilise air rights. Of course, New Zealand and China have recently agreed to double the number of permitted frequencies between the countries.

#### **No competitive detriment**

5.22 Based on the above analysis, the coordination of services between Air New Zealand and Air China does not give rise to any real competition issue.

(a) **Air China does not operate direct or indirect flights** between China and New Zealand and therefore the Parties therefore do not directly or indirectly overlap on any route. As noted, Air China can ticket passengers pursuant to an interline or codeshare, but even on that basis it only accounts for only [REDACTED]

(b) The Alliance will continue to face **strong competitive constraints** from a number of carriers for travel between New Zealand and China. Air New Zealand

currently faces direct competition on Auckland – Shanghai from China Eastern, and China Southern currently flies 11 services per week between New Zealand and Guangzhou and has recently announced plans to operate double daily from August this year. There are also a substantial number of services from a number of points in China to all major ports in eastern Australia, from which passengers can connect onto trans-Tasman flights. It is likely that the volume of services between China and both New Zealand and Australia will continue to increase, increasing the competitive pressure on the Alliance in the future.

- (c) The Alliance **does not create any relevant change** to the level of competition between New Zealand and China, or on the Auckland – Shanghai and Auckland Beijing routes specifically. With or without the Alliance, the major constraint on Air New Zealand's current service on the Auckland – Shanghai route will likely be China Eastern, which has commenced services in December and quickly increased frequency to a daily service. The Parties also face a large number of competitors offering indirect services between Auckland and Shanghai, and Auckland and Beijing, including Qantas, China Southern, Cathay Pacific and Singapore Airlines.

## 6. **NO LEGAL REASONS FOR THE MINISTER TO REFUSE TO AUTHORISE THE ALLIANCE**

6.1 In considering whether to grant authorisation for the Alliance under section 88 of the Act, sections 88(3) and (4) provide specific reasons for the Minister to decline to authorise. Section 88(4) is subject to section 88(5), which allows the Minister to authorise the Alliance if the Minister believes that to decline authorisation would have an undesirable effect on international comity between New Zealand and any other State.

6.2 For the reasons discussed below:

- (a) none of the reasons set out in sections 88(3) and (4) apply in respect of the Alliance; and
- (b) furthermore, declining authorisation would have an undesirable effect on international comity between New Zealand and China and accordingly section 88(5) provides a distinct reason for the Minister to exercise its discretion in favour of authorising the Alliance.

*No infringement of section 88(3)*

- 6.3 The Minister's authorisation of the Alliance will not prejudice compliance with any relevant international convention, agreement or arrangement to which New Zealand is a party.
- 6.4 Authorisation of the Alliance will therefore be consistent, and would not prejudice compliance, with the ASA between China and New Zealand. Moreover, the new Auckland – Beijing services and support for Air New Zealand's Auckland – Shanghai service means it allows Air New Zealand to participate in the growth in services between New Zealand and China expected over time, and contemplated by the recent expansion of permitted frequencies under the ASA.

*No infringement of section 88(4)*

- 6.5 The Parties believe that the Minister should not decline to authorise the Alliance under section 88(4) as the Alliance includes no provision that would infringe section 88(4)(a)-(f).

- (a) **No infringement of section 88(4)(a):** The Alliance makes no provision for either Applicant to directly or indirectly enforce the Alliance through any form of action by way of fines or market pressures against any person.
- (b) **No infringement of section 88(4)(b):** The Parties are aware of two commission regimes currently in force: the Civil Aviation (Passenger Agents' Commission Regime) Notice 1983 and the Civil Aviation (Cargo Agents' Commission Regime) Notice 1983.



- (c) **No infringement of section 88(4)(c):** The Alliance is likely to enhance the availability of competitive fares on the Alliance Routes, and improve outcomes for consumers of international air services.

The SAA does not prescribe actual tariffs, but puts in place a process for setting tariffs, and does not contain any provisions that unjustifiably discriminate between consumers in the availability of Alliance fares.

In addition, the Alliance parties will continue to face competitive pressure from a range of international airlines, including Qantas, China Eastern, China Southern, Sichuan Airlines, Malaysian, Thai, Cathay Pacific and Singapore Airlines.

Accordingly, neither the Alliance viewed as a whole nor any other provision of the Alliance will undermine the consumers' wide access to competitive fares either from the Parties or their competitors on the Alliance Routes.

- (d) **No infringement of section 88(4)(d):** The SAA [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
does not preclude any carrier operating those routes in its own right.

The Parties will continue to set tariffs having regard to existing and potential competition from other carriers on all routes on which they operate. Authorisation will not have any flow-on impact in terms of ASAs or other regulatory conditions that would impact another airline's access to the Alliance Routes.

Further given the low barriers to entry on the Alliance Routes, and the existence of strong, established international competitors, the Parties will have no incentive to set tariffs so as to exclude any person from providing international air services on any of the Alliance Routes.

- (e) **No infringement of section 88(4)(e):** Clause 12.2 of the SAA [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED].

- (f) **No infringement of section 88(4)(f):** No penalty is payable under the Alliance when a party withdraws on reasonable notice.<sup>10</sup>

The SAA provides for an initial five year term from the date on which regulatory approvals are received to the Parties' satisfaction.<sup>11</sup> It can be terminated early in specific circumstances. The Implementing Agreements are contingent upon the continuation in force of the SAA.

<sup>9</sup> Clause 4.5(f)(iii) of the SAA.

<sup>10</sup> Clause 9.4 of the SAA.

<sup>11</sup> Clause 9.1 of the SAA.

Following the initial term, the SAA may be terminated on six months' notice. As the Ministry has recognised in the past, alliance agreements provide for a greater degree of commitment by the parties than lesser forms of cooperation, such as codeshare arrangements.

*International comity*

- 6.6 If the Minister concludes, contrary to the view of the Parties, that the Alliance does not comply with any of section 88(4)(a)-(f), he can nevertheless authorise the Alliance under section 88(5) if declining authorisation would have an undesirable effect on international comity between New Zealand and another state.
- 6.7 The Statement of Intent for the Alliance was signed on 21 November 2014. The Statement of Intent was signed as part of Chinese President Xi Jinping's state visit to New Zealand, following approval for inclusion in the official programme by the Civil Aviation Authority in China (**CAAC**). One of the primary drivers of the Alliance is to re-establish direct air services between New Zealand and the Chinese capital. Declining authorisation would have an undesirable effect on international comity between New Zealand and China. In parallel with the Ministry's review, the Alliance will also be submitted for review to the Chinese competition law regulator. In the Parties' view, declining authorisation on the basis of any of the section 88(4)(a)-(f), despite the clear consumer benefits that would arise from the Alliance and the support for the Alliance in China, would have an undesirable effect on international comity between New Zealand and China. Accordingly international comity provides a distinct reason for the Minister to exercise his discretion in favour of authorising the Alliance.