

June 2020

PUBLIC VERSION

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

1. EXECUTIVE SUMMARY

Overview

- 1.1. Air New Zealand and Air China seek authorisation from the Minister to continue to operate their Alliance through the Strategic Alliance Agreement (**the SAA**).
- 1.2. The outbreak of COVID-19 has severely impacted the global economy, none more so than the aviation and tourism economies. Trade and tourism between New Zealand and China has been particularly hard hit. As at 30th June 2020, five months after Air New Zealand first suspended its Shanghai service in response to COVID-19, Alliance passenger services between New Zealand and China remain significantly reduced due to travel restrictions imposed by both the Chinese and New Zealand Governments and continued concerns around COVID-19. There remains considerable uncertainty around when normal services can be resumed, however a sustained reduction of services into 2021 is likely.
- 1.3. The Alliance will be particularly important as the New Zealand tourism industry seeks to recover from the impact of COVID-19 over the next five years. Pre-COVID, China was New Zealand's second largest tourism market with visitor arrivals reaching over 400,000 per year (a growth of approximately 18% in the period since the Alliance began), with Chinese tourism spend in New Zealand in excess of NZD1.7Bn in the year ending 2018. Prior to COVID-19, it was predicted that arrivals from China would grow by over 50% to nearly 700,000 per year by 2025.¹ The Alliance services will be fundamental if the New Zealand-Chinese tourism industry is to recover to pre COVID-19 levels, let alone resume a growth trajectory. The Alliance not only provides two points of entry for passengers travelling into and from China but it also enables the Parties to work together with New Zealand and Chinese tourism agencies to re-build demand in tourism between China and New Zealand.
- 1.4. It is impossible to predict with any certainty what the competitive landscape for passenger air services between New Zealand and China will look like in a post-COVID world. During the current authorisation, the Chinese aviation industry has been characterised by both large state-backed competitors (e.g. China Southern and China Eastern) as well as opportunistic, nimble smaller competitors. Pre-COVID, these competitors demonstrated a willingness to quickly enter, expand and exit services between New Zealand and China depending on market conditions (as evidenced by the rapid influx and expansion of Chinese carriers to New Zealand from 2016 to 2018, and their subsequent rationalisation in 2019 – behaviour which is indicative of open and competitive markets). Post-COVID, the Alliance will continue to be constrained by these competitors as well as by market dynamics.
- 1.5. While it is expected that other Chinese carriers will continue to operate to New Zealand (and constrain the Alliance), the China- New Zealand route does not hold the same strategic importance for these carriers as it does for Air New Zealand and hence the Alliance. New Zealand is just one route on offer in the wider network of these Chinese carriers and they are not concerned with furthering New Zealand's wider interests or re-building New Zealand's tourism market per se. They are much more likely to exit services (or not resume services) if they see better opportunities elsewhere. To the contrary, the Alliance is focused on achieving long term, sustainable growth - a goal which is much more aligned with New Zealand's strategic objectives and the growing bilateral relationship between China and New Zealand.
- 1.6. The outbreak of COVID-19 in China impacted Alliance services from as early as January 2020. As such, the analysis in this application is limited to an assessment of the historic performance of the Alliance during the period between December 2015 and December 2019. Moreover, given the continued uncertainty of the full impact of COVID-19 on the New Zealand - Chinese aviation and tourism industries, the Parties have necessarily limited any forward-looking statements regarding the Alliance operations (i.e. with respect to capacity, schedule, growth, services, routes etc). Over the coming months, the Parties will continue to monitor developments and will provide the MOT with all material updates concerning the resumption of Alliance operations.

¹ MBIE Tourism Forecast 2019-2025, May 2019.

Summary of Alliance in the first period of authorisation

- 1.7. Over the first period of authorisation, the Alliance has fulfilled its stated objectives. Air China has provided support to Air New Zealand's Shanghai services through its sales and distribution network, and strong stakeholder relationships. This support has enabled Air New Zealand to compete more effectively with other Chinese carriers. The Alliance has also enabled the successful launch of the first direct services between Beijing and Auckland since Air New Zealand exited the route in 2012. Air New Zealand has supported this new service through increased network reach into domestic New Zealand, sales and marketing support as well as guidance on revenue and performance management. The successful launch of the Beijing service has provided the New Zealand public with more choice and availability of services to China as well as ensuring greater distribution of Chinese tourism spend throughout domestic New Zealand.
- 1.8. The Alliance has achieved these objectives without any detrimental impact on competition:
- (a) **No direct overlap:** the parties do not operate direct services on the same routes. **[REDACTED]**. Therefore, re-authorisation does not eliminate any direct competition between the Parties;
 - (b) **Significant increase in overall capacity of direct services between China and New Zealand:** pre-COVID-19, capacity from competitors operating direct services between China and New Zealand more than doubled over the course of the Alliance. This clearly demonstrates that the Alliance has not had any detrimental impact on entry and expansion of competition;
 - (c) **Increase in direct competition between Shanghai and Auckland:** China Eastern has continued to grow capacity and compete aggressively with the Alliance between Shanghai and Auckland. In 2016, it began operating year-round daily service to Auckland and in 2019, it replaced its Airbus 330-200 with larger Dreamliner 787- 9s;
 - (d) **New entry from secondary cities:** the Alliance has not disincentivised other carriers from launching new services to New Zealand from other gateways in China. In the period since authorisation:
 - Hainan launched services from Shenzhen
 - Sichuan Airlines launched services from Chengdu; and
 - Tianjin Airlines launched services from Tianjin.²
 - (e) **Increased constraint from one-stop carriers:** one-stop carriers have continued to constrain the Alliance with multiple carriers operating one-stop services between both Shanghai and New Zealand and Beijing and New Zealand, particularly via Australia and other Asian hubs.
- 1.9. The above demonstrates that, prior to the outbreak of COVID-19, the Alliance was operating in a significantly more competitive environment than in the period prior to the authorisation. The authorisation period has been characterised by substantial growth in capacity from China to New Zealand with the entry of several new Chinese carriers who have commenced services to New Zealand and pursued an aggressive low fare strategy. This has meant passengers travelling between China and New Zealand have more travel options than when the Alliance commenced in 2015. Despite this challenging operating and competitive environment, the Alliance has delivered the following benefits to New Zealand:
- (a) **Successfully embedded the new Beijing service:** over the course of the Alliance, the parties have grown passenger traffic on the Beijing service by **[REDACTED]** and increased capacity by 20%. The financial performance of the Beijing service has also improved steadily over the course of the Alliance with Air China benefitting greatly from Air New Zealand's sales distribution strength in New Zealand, as well as its **[REDACTED]**;

² Tianjin discontinued these services in March 2019

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- (b) **Supported Air New Zealand's Shanghai service:** the parties have leveraged Air China's sales and distribution network and strong stakeholder relationships in China to combat some of the structural disadvantages it faces in Shanghai. Air New Zealand has managed to maintain passenger volumes and capacity in Shanghai despite aggressive competition from Chinese carriers;
 - (c) **Increase in capacity and passenger volumes:** the Alliance has grown capacity between New Zealand and China by 8% over the course of the Alliance through the upgrade of Air China aircraft from A330-200s to Dreamliner 789s, and the introduction of additional seasonal frequencies. The Alliance has also grown passenger traffic on Alliance services by approximately [REDACTED] this period;
 - (d) **Lower average fares:** there has been a reduction in average fares across all cabin classes on both Shanghai and Beijing services, including economy class fares which have reduced by [REDACTED] respectively on Shanghai and Beijing. Additionally, the Alliance has expanded the Codeshare and Special Prorate Agreements to provide better and cheaper access to each other's beyond networks;
 - (e) **Stimulation of tourism:** in the period between December 2015 and December 2019, Chinese visitors to New Zealand have grown by over 18%. The Alliance has contributed to this growing number of visitors through the launch of the Beijing service as well as the numerous sales and marketing campaigns it undertakes in China to encourage tourism to New Zealand – over the course of the Alliance, the parties have allocated approximately [REDACTED] on sales and marketing campaigns in New Zealand, as well as undertaking joint initiatives with Tourism New Zealand;
 - (f) **Greater New Zealand connectivity:** the Alliance ensures that a growing number of Chinese tourists are travelling beyond Auckland due to the additional incentive the Alliance creates for Air New Zealand to provide greater access to its domestic network to Air China. The number of Air China passengers connecting onto Air New Zealand's domestic network from Alliance services [REDACTED];
 - (g) **Improved access to China and beyond:** while connectivity to Air China's domestic network is not a primary driver for Air New Zealand, the Alliance has provided Air New Zealand customers with better access onto Air China's beyond network through an expanded Codeshare agreement and better SPA rates;
 - (h) **Loyalty and customer benefits:** Air New Zealand customers have earned significantly more Airpoint Dollars on travel between New Zealand and China – with an additional [REDACTED] earned on the Beijing service over the course of the Alliance. 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;
 - (i) **Schedule optimisation:** in 2019, Air New Zealand (with the assistance of Air China) secured more consistent first bank departure times from Shanghai on all days of the week (resulting in greater convenience for passengers and greater operational efficiencies for Air New Zealand);
 - (j) **Continued competition in cargo to China:** the Parties continue to compete for air freight between New Zealand and China. This means New Zealand exporters and importers continue to have greater choice for trading goods between New Zealand and China. This will continue to be a key benefit, particularly in the light of the increased importance of cargo revenues since the outbreak of COVID-19 and in the longer term, the enhanced trade deal announced at the end of 2019 which will lead to greater trade between New Zealand and China.
- 1.10. The potential concerns raised by the MOT in its 2015 Report have not eventuated. The Alliance has not constrained growth or competitive pricing on the Beijing - Auckland route – with average fares declining and capacity increasing. Moreover, the Alliance has not prevented other direct services commencing or expanding from China to New Zealand. Overall, the Alliance has delivered on its stated objectives and has accrued substantial benefits for New Zealand.

Authorisation Sought

- 1.11. The Minister's discretion to authorise the Alliance is provided for in Section 88(2) of the Act. The Applicants believe the Alliance meets the test for authorisation and the Minister should exercise his discretion to reauthorise the Alliance pursuant to section 88 of the Act for a further period.
- 1.12. The Applicants have sought reauthorisation until 31 March 2026 (being a five-year period, ending at the end of the 2025 IATA Northern Winter season). The first authorisation period was five years and four months. 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. The fall-out from COVID-19 is likely to have long-lasting and substantial impacts on the aviation tourism industries— this is already evident through a number of earnings downgrades by organisations in the tourism industry (including Air New Zealand). It is important that New Zealand demonstrates its support through this period for New Zealand's tourism industry which heavily relies on Chinese tourists, as well as for Chinese tourism operators to work with New Zealand, from a comity perspective. A five-year re-authorisation period would enable the Alliance to work with New Zealand and Chinese tourism agencies to re-build the Chinese demand for travel to and within New Zealand. A longer term would also assist the export community to plan and rebuild trade to China which has been severely effected by 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 Air New Zealand's Shanghai service 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.
- 2.1 Air New Zealand is New Zealand's national flag carrier and offers air services in New Zealand and internationally. Air New Zealand operates a global network that provides air passenger services and cargo transport services to, from and within New Zealand to more than 15 million passengers a year.
- 2.2 The New Zealand Government owns approximately 52% of Air New Zealand, with the remainder owned by private investors. Air New Zealand is listed on the New Zealand and Australian stock exchanges.
- 2.3 Air China is one of China's largest airlines. Its corporate offices and main operations base are in Beijing (Beijing Capital International Airport). As at the end of January 2020, Air China operated 453 routes to 187 cities in 43 countries.
- 2.4 Air China is listed on the Hong Kong, London, and Shanghai 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. Air China also owns a minority stake in Cathay Pacific.

The Alliance

- 2.5 In 2015, the Minister granted Air New Zealand and Air China authorisation pursuant to Section 88 of the Civil Aviation Act 1990 (the **CAA**) to make and give effect to the China Strategic Alliance Agreement (the **SAA**), the Code Share Agreement and a number of **Implementing Agreements** (together, the **Alliance**).
- 2.6 The SAA provides for varying levels of coordination between the parties in relation to:
- (a) the "**Alliance Sectors**", being sectors operated by either airline directly between New

Zealand and China (i.e. Auckland –Shanghai and Auckland - Beijing); and

- (b) the “**Feeder Routes**”, which comprise services within New Zealand and China which include an Alliance Sector.
- 2.7 In relation to Feeder Routes, the SAA provides for varying levels of coordination between the parties in relation to; joint pricing and coordinated revenue management joint sales and marketing, optimising connection requirements for domestic sectors (to the extent practical), and aligning FFP customer handling. In relation to Alliance Sectors, the SAA provides for all of the coordination outlined above as well as; revenue sharing, network planning (including capacity), coordinating operational requirements, aligning airport operations and where possible harmonising customer experience.
- 2.8 In addition to the SAA, the Alliance is supported by several “Implementing Agreements”. These include:
- (a) a Codeshare Agreement which includes both Alliance Sectors and Feeder Routes, with the number of Feeder Routes increasing over the course of the Alliance;
- (b) an enhanced “Special Prorate Agreement” (SPA) which provides favourable rates and access to each party’s network;
- (c) “FFP Agreement” which aligns the parties FFP programs; and
- (d) a “Revenue Sharing Agreement” which sets out the terms on which the parties will allocate revenue generated on the Alliance Sectors.

Alliance Schedule

- 2.9 In Northern Winter 2015/2016, Air China commenced daily Northern Winter services between Beijing and Auckland. The current (pre-COVID-19) schedule is set out in Table 1 below:

Table 1: Alliance flight schedule from Northern Summer 2020

Northern Summer Schedule (April - October)						
Flight Number	From	To	Departure Time	Arrival Time		Days of Week
NZ 289	AKL	PVG	23:00	07:15	+1	Mon - Sun
NZ 288	PVG	AKL	14:15	05:45	+1	Mon - Sun
CA 783	PEK	AKL	01:05	17:40		.Tu.Th....SaSu
CA 784	AKL	PEK	19:30	04:30	+1	.Tu.Th.....SaSu
Northern Winter Schedule (November - March)						
Flight Number	From	To	Departure Time	Arrival Time		Days of Week
NZ 289	AKL	PVG	23:59	07:05	+1	Mon - Sun
NZ 288	PVG	AKL	14:15	06:45	+1	MoTu..ThFrSaSu
NZ 288	PVG	AKL	15:00	07:30	+1We.....
CA 783	PEK	AKL	01:05	18:15		Mon - Sun
CA 784	AKL	PEK	20:20	04:30	+1	Mon - Sun

- 2.10 Operational changes since authorisation include (prior to the outbreak of COVID-19)
- (a) At the end of October 2016, Air China replaced its Airbus 330-200s with the larger Dreamliner 787-9s resulting [REDACTED] increase in seats per flight.
- (b) In Northern Winter 2016 (from 10 January to 5 March 2017) and Northern Winter 2017 (from 18 January 2018 to 18 February 2018) covering the Chinese New Year periods, Air New Zealand operated a second bank three times a week between Shanghai and Auckland. Due to the [REDACTED], Air New Zealand did not apply for second bank slots for the 2019

Chinese New Year period.

- (c) From Northern Summer 2020, with Air China's assistance, Air New Zealand secured aligned departure times for all of its daily NZ286 flights from Shanghai to Auckland (from 14:15pm). Once normal services eventually resume, this aligned schedule will provide passengers with better convenience and consistency. It also reduces the amount of ground time that Air New Zealand's spends in Shanghai leading to greater operational efficiencies for Air New Zealand, [REDACTED].

Commercial Rationale

- 2.11 The commercial rationale for the Alliance has not materially changed since the Applicant's 2015 application (the **2015 Application**).
- 2.12 For Air New Zealand, the Alliance continues to provide Air New Zealand with greater security of its Shanghai services through the support of a strong Chinese carrier. [REDACTED].
- 2.13 As further detailed in our confidential submission, these structural disadvantages continue to make the route financially challenging for Air New Zealand. However, the Alliance has helped Air New Zealand to 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 detailed further below, over the course of the Alliance, the parties have implemented a number of strategic initiatives to support Air New Zealand's Shanghai service. Through these initiatives the Alliance has been able to maintain passenger volumes on its Shanghai services despite aggressive competition from Chinese carriers over the course of the Alliance.
- 2.14 For Air China, the Alliance continues to ensure it has the support of Air New Zealand to sustain and grow the Auckland-Beijing service – which will be particularly important as the aviation industry recovers from COVID-19. In the first period of authorisation, Air New Zealand supported Air China through a number of means including; better and cheaper access to its domestic network; sales and marketing support (including cross metal sales); and, [REDACTED].

Key Market developments

COVID-19

- 2.15 As noted above, the outbreak of COVID-19 has had a severe impact on the tourism and the aviation industries.
- 2.16 In response to the outbreak and the measures taken by each of the Chinese and New Zealand Governments, the parties were forced to suspend Alliance services. [REDACTED].

Deepening China - New Zealand bilateral relationship

- 2.17 Prior to the outbreak of COVID-19, New Zealand and China had been deepening their bilateral relationship. In November 2019, the New Zealand Government announced an update to the Fair-Trade Agreement (**FTA**) with China. The updated agreement includes a number of improvements to facilitate free flow of goods by improving transparency and reducing red tape for goods in transport as well as a number of areas which will particularly support New Zealand exporters. This expanded FTA recognises that China is New Zealand's largest trading partner, with two-way trade exceeding \$32 billion and New Zealand enjoying a \$5.2 billion surplus under the relationship.
- 2.18 The tourism relationship between New Zealand and China has also deepened. On 26 June 2019, the Ministry of Business, Innovation and Employment of New Zealand (MBIE) and the Ministry of Culture and Tourism of the People's Republic of China entered into arrangement which acknowledged the previous cooperation between the parties and committed to further areas of cooperation with the aim of strengthening economic ties through promoting two-way tourism and more regular dialogue and information exchange around tourism matters.
- 2.19 These developments reinforce the unique relationship that New Zealand has with China and the importance of China to New Zealand's trade and tourism economy. The Alliance supports this

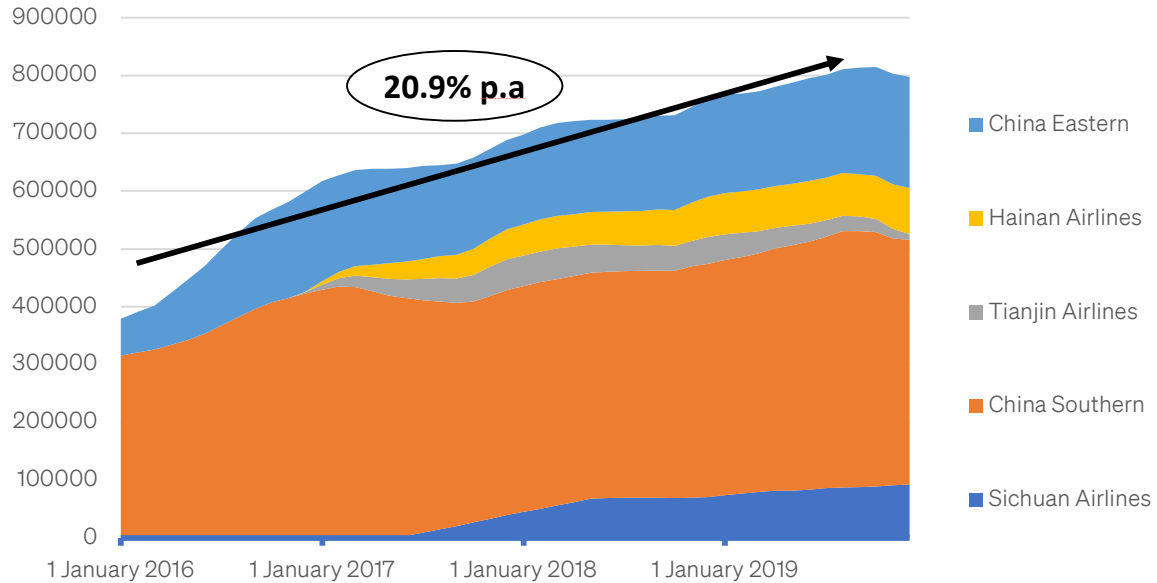
relationship by ensuring there are sustainable, long term air services operating between the two countries.

Aviation market - competitor entry and expansion

- 2.20 Over the first period of the authorisation, there was a significant increase in competition in aviation services between New Zealand and China driven by aggressive entry and expansion of Chinese carriers, particularly between 2017 and 2018. This was primarily driven by the entry of secondary Chinese carriers commencing direct services to New Zealand from additional ports in China, as well as significant capacity increases particularly by China Southern, from Guangzhou.
- 2.21 This competitor growth was supported by an expanded Air Services Agreement (the **ASA**) with China which increased the weekly limit of passengers services between New Zealand and China from 49 to 59 per week (which in turn, was increased from 42 services per week in 2016).
- 2.22 Since the Alliance was authorised:
- (a) China Southern Airlines commenced direct services to Christchurch;
 - (b) Sichuan Airlines commenced services between Chengdu and Auckland;
 - (c) Hainan Airlines commenced services between Shenzhen and Auckland; and
 - (d) Tianjin Airlines commenced direct services between Tianjin and Auckland³.
- 2.23 This unprecedented entry and expansion has resulted in an increase of direct capacity between New Zealand and China of 110% Year 1 and Year 4 at an annual growth rate of nearly 21%.

³ Tianjin Airlines suspended its Chongqing services in March 2019.

Figure 1: Capacity increases by competing Chinese carriers over the course of the Alliance operating direct services between China and New Zealand
 Source: Diao



2.24 [REDACTED].

Inbound Chinese visitor market decline

2.25 Following a long period of strong year on year growth, visitor arrivals from China fell by over 9%⁴ between 2018 and 2019 (to approximately the same level of arrivals in 2016), reflecting the general slow-down in the Chinese economy.

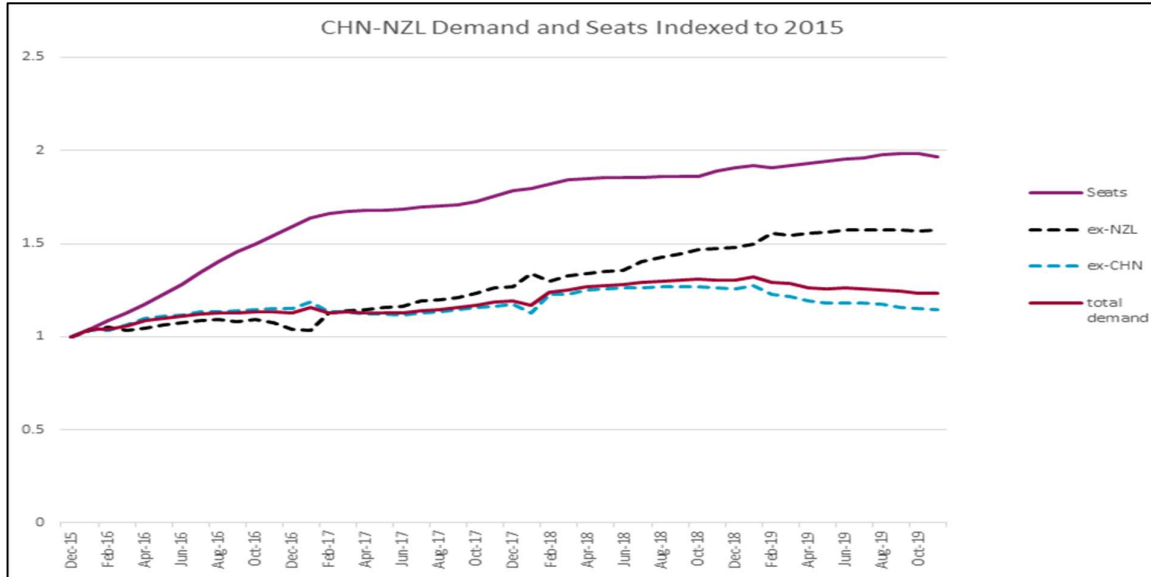
2.26 This decline in the market exacerbated the over-capacity issues already present in the market and has led to some rationalisation of capacity by Chinese carriers during 2019 – for example Tianjin Airlines suspended its services to New Zealand in March 2019 and China Southern has reduced frequencies on its Christchurch services. Notwithstanding these reductions, prior to the outbreak of COVID-19, capacity growth was still outpacing current and projected market demand.

⁴ Stats NZ data.

2.27 Figure 2 demonstrates how capacity growth has significantly outpaced overall demand growth since the Alliance commenced:

Figure 2: China – New Zealand capacity and demand growth indexed from the commencement of the Alliance

Source: Diiio and Stats NZ



Overview of developments in the Alliance Services

2.28 Notwithstanding the challenging competitive and operating environment set out above, the Alliance has grown both total capacity and total passenger numbers during the period of authorisation as shown in Table 2 below.

Table 2: Alliance capacity and passenger traffic since the Alliance commenced
Source: Stats NZ data and Air NZ Data

		Year 1	Year 2	Year 3	Year 4
		Jan 16- Dec 16	Jan 17 -Dec 17	Jan 18 – Dec 18	Jan 19 -Dec 19
Total Passenger numbers	Shanghai	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
	Beijing	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
	Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total Capacity (ASKs)	Shanghai	2,054,774,176	2,176,945,088	2,115,635,328	2,036,512,092
	Beijing	1,340,859,408	1,521,854,208	1,629,702,144	1,617,719,040
	Total	3,395,633,584	3,698,799,296	3,745,337,472	3,654,231,132

- 2.29 Alliance services between Auckland and Beijing have shown strong levels of sustainable growth, especially when considered against the capacity expansion and low fare strategy employed by other Chinese carriers over the period. Capacity has grown by nearly 21% and traffic by approximately [REDACTED].
- 2.30 Alliance services between Shanghai and Auckland have also performed well. The Alliance has maintained capacity and passenger numbers over the period despite competition from China Eastern which continues to leverage the advantages of its Shanghai hub to drive traffic onto its services from its beyond network.

3. PUBLIC BENEFITS DELIVERED BY THE ALLIANCE:

- 3.1 The Alliance has been successful in achieving significant benefits for New Zealand including:

- (a) Supported Air New Zealand's services between Shanghai and Auckland;
- (b) Successfully launched new route between Beijing and Auckland;
- (c) Increased total capacity travelling on the Alliance services;
- (d) Decreased average fares across all fare classes on both routes
- (e) Increased connectivity onto both beyond networks;
- (f) Stimulation of tourism to New Zealand; and
- (g) Enhanced loyalty and FFP benefits.

- 3.2 The Applicant's set out these benefits in more detail below.

Air China has supported Air New Zealand's Shanghai – Auckland services

- 3.3 As set out in our 2015 application, Shanghai is one of New Zealand's most heavily weighted inbound destinations. This means the Shanghai route has historically been very challenging for Air New Zealand to operate as it is competitively disadvantaged relative to Chinese competitors.
- 3.4 For this reason, China Eastern, has a clear competitive advantage over Air New Zealand by virtue of its beyond network. Shanghai is China Eastern's primary hub – with approximately 75% of its international available seat kilometres (ASKs) passing through Shanghai. China Eastern can leverage its network beyond Shanghai to drive traffic onto its Auckland services. Approximately 51% of China Eastern's Shanghai – Auckland traffic comes from Chinese ports beyond Shanghai.
- 3.5 In the first period of authorisation, through the Alliance, the parties have worked hard to combat these structural disadvantages. The parties have:
- (a) Expanded the Codeshare and SPA Agreement between the parties providing for greater connectivity and preferential rates for connectivity beyond Shanghai – see section 3.23 to 3.27 below for more detail;
 - (b) Initiated a "China Regional Strategy" targeting key beyond Chinese cities through joint sales workshops and trade visits. [REDACTED];
 - (c) [REDACTED];
 - (d) authorised Air China to represent Air New Zealand in negotiations with Chinese online travel agents (OTA) [REDACTED]. Unfortunately, the outbreak of COVID-19, has delayed the expected benefit of these negotiations;
 - (e) Enhanced Air China's direct online sales platforms to better support sales of Shanghai

services. [REDACTED]; and

- (f) Undertaken significant joint promotional activity in China to promote New Zealand as a destination – see Section 3.28 below for more detail;
 - (g) improved the volume of cross metal sales made by Air China on Air New Zealand's Shanghai services during the period of authorisation (increasing from [REDACTED] in Year 1 to [REDACTED] in Year 4).
- 3.6 These measures have helped Air New Zealand maintain its competitiveness with other Chinese carriers. [REDACTED].

The Alliance has successfully established and grown the Beijing - Auckland route

- 3.7 As demonstrated in Figure 3 below, since the Alliance commenced, passenger volumes on the Beijing service have grown every year since it was launched resulting in an overall increase by [REDACTED]. Moreover, capacity has grown by over 20% as a result of increases in seasonal frequencies and an upgrade in Air China aircraft operating the services.

Figure 3: Capacity and traffic growth on Beijing – Auckland services

Source: Air NZ data

[REDACTED]

- 3.8 The launch of the Beijing services has resulted in a significant increase in the number of inbound visitors from Beijing – with arrivals increasing by over 20% from 2015 to 2016 as Chinese tourists availed themselves of the new direct services.⁵ This has brought direct and substantial tourism benefits through increased tourism spend throughout New Zealand.
- 3.9 The Alliance's share of the Beijing market has improved over the course of the Alliance from 28% in Year 1 to approximately 34% in Year 4⁶. This indicates that the Alliance has improved its service over time and passengers increasingly value the significant time and scheduling benefits of the Alliance's direct service over indirect options (although these services continue to exert significant price constraint on the Alliance).
- 3.10 [REDACTED].
- 3.11 Air New Zealand has contributed significantly to the success and improvement of Air China's service through:
- (a) Sales and distribution strength in New Zealand;
 - (b) cross metal sales [REDACTED];
 - (c) joint promotional activity in New Zealand (which has both promoted Air China's Beijing service and also improved Air China's brand awareness and trust within New Zealand); and
 - (d) technical know-how and insights in [REDACTED].
- 3.12 In summary, the Alliance has been successful in launching the Beijing service over the first period of authorisation.

Increased overall capacity on Alliances services

- 3.13 In its 2015 application, the parties submitted that it expected to increase capacity over time, subject to the success of the Alliance sectors. As demonstrated above, the parties increased capacity on Beijing through an upgrade of Air China's aircraft from A330s to 787s and the addition of daily seasonal frequencies.

⁵ According to Stats NZ for the year ended November, visitors from Beijing increased from 45,936 in 2015 to 55,488 in 2016.

⁶ Stats NZ and Air NZ data

- 3.14 The parties also increased capacity on its Shanghai service through additional seasonal frequencies which operated three times a week during the Chinese New Year periods in Northern Winter 2017 and 2018. **[REDACTED]** these services were discontinued. Nonetheless, the Alliance has demonstrated its commitment to add capacity where feasible.
- 3.15 As demonstrated in Table 5 above, overall capacity of Alliance services has increased by approximately 8% over the authorisation period.

Lower average fares and access to lower fare inventory

- 3.16 As demonstrated in Figure 5 and 6 below, average fares across all cabin classes on Alliance services have decreased over the course of the Alliance. Notably, average economy fares have decreased by [REDACTED] on Shanghai Services and by [REDACTED] on Beijing services.

Figure 5: Shanghai Alliance average fares (in CNY - unadjusted)

Source: Applicants' data

[REDACTED]

Figure 6: Beijing Alliance average fares (CNY - unadjusted)

Source: Applicants' data

[REDACTED]

- 3.17 This reduction in average fares demonstrates that the Alliance is constrained by other carriers operating between China and New Zealand and does not have the ability to exercise market power on either route in order to increase fares.

Connecting fares

BLS Report

- 3.18 In 2015/16 Air New Zealand commissioned a major economic study of all its alliance activity to undertake a quantitative analysis of the price effects of all of Air New Zealand's existing alliances at that time (the "**BLS Report**"). This analysis also sought to isolate and quantify the price benefits of alliances for connecting travellers. The study used actual pricing data from Air New Zealand's alliances with Air China as well as Virgin Australia and Singapore Airlines. A full copy of the report was provided as part of the 2018 Singapore Airlines/ Air New Zealand authorisation application. Despite extensive economic literature on the effects of airline cooperation, the BLS Report was the first published study extending the empirical approach of airline cooperation to the analysis of the price effect of airline revenue sharing alliances. The analysis has attracted substantial interest within the airline community as the first of its kind to empirically establish the benefits of revenue share alliances.
- 3.19 The report found that prices for connecting fares on Air New Zealand's revenue share alliance services are indistinguishable from online fares. An "online fare" is a reference to a connecting journey where the individual legs of that journey are operated by a single carrier. Connecting journeys on two different, non-aligned carriers, are generally inferior to a connecting journey on a single carrier - there is no alignment on schedule and they are more expensive due to double marginalisation⁷. However, the BLS Report found that Air New Zealand's connecting alliance fares are similar (better schedule, lower price) to those on a single ("online") carrier, as alliance partners are incentivised to optimise scheduling and share in the revenue benefits of any connecting journeys.⁸
- 3.20 The analysis provided "clear and unique evidence" that Air New Zealand's alliance strategy provided lower fares for connecting travellers and indicates that alliance partners operate as though they were a single airline, providing substantial fare benefits to customers who make international connecting trips to/from New Zealand. The BLS report found that the closeness of cooperation was the key to these lower fares, i.e., the ability of Air New Zealand and its partners to offer the most efficient, lowest, connecting fares would not be realised outside of a revenue sharing alliance.
- 3.21 Overall, the study provided compelling evidence that prices for international JV (excluding the Tasman) connecting fares are 8.8% to 11.6% lower than traditional interline fares. While this part of the study included all of Air New Zealand's long-haul alliances, the incentives created by the

⁷ Pages 11 and 12 of the BLS Report

⁸ Page 5 of the BLS Report

Alliance, including the sharing of revenue and the SPA arrangements, are the same factors identified in the BLS Report as leading to relatively lower fares in revenue sharing alliances. Therefore, the BLS Report provides empirical evidence showing that benefits obtained from the sharing of alliance revenue and more closely aligned SPA arrangements are passed onto consumers.

- 3.22 As discussed below in 3.24, the parties have revised the Codeshare and Special Prorate Agreements between the parties resulting in expanded connectivity and reductions on average billing rates on connecting routes (which the BLS report shows are passed onto consumers).

Greater connectivity

- 3.23 The Alliance incentivises the parties to provide better access to connecting passengers than what would be available without the Alliance because the parties obtain a share of the revenue of every extra passenger that travels on an Alliance route. This is reflected in the improved SPA and Codeshare Agreement that have been agreed between the parties.
- 3.24 Since authorisation, the parties have added an additional **[REDACTED]** routes to the existing Codeshare Agreement and an additional **[REDACTED]** routes to the SPA (**[REDACTED]**). Moreover, economy billing rates under the latest SPA are considerably lower for the vast majority of routes than the rates the parties made available to each other in the SPA that existed prior to the Alliance
- 3.25 Absent the Alliance, neither party would be incentivised to provide such favourable access and availability. As discussed in paragraphs 3.18 to 3.22 above, the BLS report commissioned by Air New Zealand provides empirical evidence that the benefits obtained from SPA arrangements between Alliance partners are passed on to consumers. This means that the reductions in SPA rates outlined above directly benefit Alliance passengers in the form of lower connecting fares than what would be available absent the Alliance.
- 3.26 While connectivity into mainland China is not a primary focus of the Alliance for Air New Zealand, the number of Air New Zealand passengers connecting into domestic Air China services over the course of the Alliance **[REDACTED]**). This indicates that passengers are benefiting from the improved Codeshare and SPA.
- 3.27 For Air China, the Alliance provides Air China with a key gateway into domestic New Zealand. As demonstrated in Figure 7 below, there has been a substantial increase of Air China passengers connecting onto Air New Zealand's domestic network beyond Auckland from approximately **[REDACTED]** passengers in the year prior to the Alliance to over **[REDACTED]** in Year 4. As discussed further below, this influx of Air China passengers connecting into Air New Zealand's domestic network ensures the tourism benefits of the Alliance are distributed throughout New Zealand.

Figure 7: Alliance passengers connecting onto each other's respective network

Source: Air NZ data

[REDACTED]

Stimulation of tourism to New Zealand

- 3.28 As the Ministry will be aware, tourism from China to New Zealand has grown substantially since the Alliance was authorised at the end of 2015. Total visitor arrivals from China increased by 26% between 2015 (the pre-Alliance year) and 2018 (Year 3 of the Alliance). As discussed above, there was a slowdown in arrival numbers in 2019 which mirrored the slowdown in the Chinese economy, however arrivals from China still grew by approximately 14% in 2019 compared to pre-Alliance levels.
- 3.29 The successful launch and development of the Beijing route Alliance has contributed significantly to this increase in inbound tourism from China. Over 30,000 Chinese tourists travelled to New Zealand

via Beijing in 2019.⁹ Based on Ministry of Business, Innovation and Employment data, the average Chinese tourist expenditure in New Zealand for the year ending September 2019 was \$1829. Therefore, Chinese tourists travelling on Alliance services contributed approximately \$56.7 million to the New Zealand economy in 2019.

- 3.30 The Alliance has also stimulated tourism to New Zealand through significant investment in sales and marketing activity in China to promote destination New Zealand. The parties have allocated over [REDACTED] to marketing campaigns in China over the course of the Alliance, several of which have targeted Air China's passenger base through Air China's official website and social media accounts as well through magazines and other print channels. The parties have also undertaken joint marketing campaigns with Tourism New Zealand in China.
- 3.31 The Alliance has ensured that the benefits of this increase in tourism are distributed to different geographical regions throughout New Zealand due to the incentive that the Alliance creates for Air New Zealand to open its domestic network to Air China passengers. Table 3 below shows the significant growth in Air China passengers connecting to domestic New Zealand over the course of the Alliance.¹⁰

Table 3: Air China passengers connecting onto Air New Zealand's domestic network

Source: Air NZ data

	Pre -Alliance	Year 1	Year 2	Year 3	Year 4
Wellington	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Christchurch	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Queenstown	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Dunedin	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Palmerston North	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
All domestic NZ ODS	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

- 3.32 As set out in the BLS report, passenger flows from the Alliance services onto Air New Zealand's domestic services is important not just for the benefits the passengers themselves bring to their ultimate destination, but it also contributes to the viability of Air New Zealand's domestic services themselves. At the time the study was carried out, approximately 47% of Air New Zealand's passengers travelling on a typical long-haul international flight make a connection behind/beyond Air New Zealand's Auckland hub. The BLS Report concludes that alliances have "served to strengthen Air New Zealand's *domestic network*, thereby helping it to maintain (and in some cases increase) service in domestic markets".¹¹

Optimisation of Flight schedules

- 3.33 At the time of the initial application for authorisation, the parties were assessing how to optimise the schedule of the Beijing service to maximise connectivity at both ends of the route. This was achieved - with both the north and southbound flights leaving late in the evening thereby allowing passengers to connect from other parts of China and New Zealand respectively.
- 3.34 The applicants continue to optimise the timing of the Alliance flights in order to achieve the most beneficial flight schedule. While this has been challenging due to slot constraints at Shanghai

⁹ According to Stats NZ data

¹⁰ Applicant's data

¹¹ BLS Report

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airport, Air New Zealand, with Air China's assistance, has been successful in aligning all of its departure times for its daily services from Shanghai with the new aligned schedule coming into effect from Northern Summer 2020. This consistency in departure time provides further convenience to passengers and it reduces the ground time that Air New Zealand's aircraft spends in China which results in operational efficiencies and cost savings. [REDACTED].

Premium customer handling, lounge and FFP benefits

FFP accrual and Airpoint Dollars

- 3.35 In the 2015 application, the parties submitted that there would be a number of improvements for Airpoint members and Air China Phoenix Program members under the Alliance. As set out below, the majority of these improvements have been realised
- (a) FFP members of each party are able to earn benefits across more booking classes on each other's operated flights than would be available absent the Alliance;
 - (b) Earn rates have been aligned so that Airpoint members earn New Zealand rates when flying on Air China's Beijing service and vice versa;
 - (c) FFP members of both parties are able to redeem their benefits on the other party's services
- 3.36 As a result of these benefits, [REDACTED].
- 3.37 Overall, Airpoints members are earning substantially more Airpoints Dollars on services to and via China than they were prior to the Alliance.

Lounge Access

- 3.38 Eligible Alliance passengers have continued to benefit from access to each parties' respective lounges.

Continuing competition in the cargo market

- 3.39 As the MOT is aware, the Alliance does not provide for coordination in the cargo market. The Alliance has enabled a new direct link between China and New Zealand giving shippers greater choice and flexibility. If the Alliance is re-authorised, shippers will continue to have better routing options for product destined to Beijing. This is particularly important as the export community responds and recovers from COVID-19.

4. COMPETITION CONSIDERATIONS: THE ALLIANCE HAS NOT RESULTED IN ANY DETRIMENT TO COMPETITION

Introduction and summary

- 4.1 The Chinese aviation industry is characterised by large state-backed competitors (e.g. China Southern and China Eastern) as well as opportunistic smaller competitors. During the first period of authorisation, these competitors demonstrated a willingness to quickly enter, expand and exit services between New Zealand and China depending on market conditions (as evidenced by the rapid influx and expansion of Chinese carriers to New Zealand from 2016 to 2018, and their subsequent rationalisation in 2019). This demonstrates there are no structural impediments to free entry and exit, which are the hallmarks of a competitive market. Post-COVID, the Alliance will continue to be constrained by both actual competition from these competitors as well as the threat of potential competition as demand for travel between New Zealand and China recovers.

No direct overlap

- 4.2 There is no direct overlap of services between the Parties. Therefore, re-authorisation will not result in the elimination of any direct competition between the parties. To the contrary, as demonstrated above, the Alliance has benefited competition by facilitating the entry of a new carrier through the launch of the Beijing route as well as ensuring that Air New Zealand is a more effective competitor to China Eastern on the Shanghai service
- 4.3 Moreover, absent the Alliance:
- (a) [REDACTED].
 - (b) [REDACTED].

Rapid entry and expansion between China and New Zealand

- 4.4 The period since authorisation has been characterised by unprecedented entry and expansion by Chinese carriers, (particularly between 2016 and 2018, before the slowdown in Chinese economy and the outbreak of COVID-19). In that period, three new carriers entered the New Zealand market (Hainan, Tianjin and Sichuan) and China Southern launched services to Christchurch. The Alliance has clearly not disincentivised competition between China and New Zealand.

Figure 8: Carriers operating between China and New Zealand as at 1 January 2019

New Zealand - Shanghai

- 4.5 During the authorisation period, Air New Zealand continued to face significant competitive constraint from both direct and indirect competitors operating between New Zealand and Shanghai.
- 4.6 China Eastern has grown substantially in the period since the Alliance was authorised - increasing its direct Shanghai - Auckland operation to a daily year-round service in 2016. As discussed above, Shanghai is China Eastern's primary hub and it has a vast network which connects beyond Shanghai into mainland China and beyond. China Eastern leverages this beyond network to drive traffic onto its Shanghai service – with approximately 51% of passengers on its Auckland - Shanghai service connecting from outside Shanghai.¹² While Air New Zealand has benefited from Air China's sales and distribution network in China, China Eastern still has a clear network advantage over Air New Zealand beyond Shanghai.
- 4.7 China Eastern has also competed aggressively on price and improved the quality of its services through the introduction of 787-9 Dreamliner's onto the route. As at December 2019, China Eastern had a 27% share of the inbound Shanghai market, up from 20% in Year 3 of the Alliance.
- 4.8 New Zealand also faces significant constraint from indirect carriers who continue to provide passengers with competitive one-stop options for travel between Shanghai and New Zealand. In particular, China Southern has a 9.5% share of the market via Guangzhou and Hainan and Sichuan offer services via Shenzhen and Chengdu, respectively. There are also number of carriers who provide one-stop options via the Tasman including Qantas as well as Chinese carriers such as Hainan, China Southern and China Eastern (who offer services via Australia in addition to their direct services to Auckland from China). These carriers represent 18% of the traffic to and from Shanghai.
- 4.9 Finally, there are several other Asian based carriers who operate one stop services to Shanghai through their Asian hubs, the largest of which include Thai Airways, Korean Airlines, and Malaysian Airlines (which are represented by "other" in the table below).

¹² Air NZ data

Table 4: Share Estimates for Shanghai – New Zealand

Source: Stats NZ via Air NZ database

[REDACTED]

New Zealand - Beijing

- 4.10 The Alliance does not give rise to any competitive overlap on services to/ from Beijing.
- 4.11 In any event, the Alliance competes with several carriers who offer one-stop services between New Zealand and Beijing – including China Southern, China Eastern, Hainan, Qantas as well as other major international airlines who operate through their various hubs in Asia. As demonstrated in Table 5 below, approximately 65% of passengers travelling between Beijing and New Zealand travel on indirect services.
- 4.12 Given the highly price sensitive nature of Chinese passengers, these one-stop services provide a significant competitive constraint on the Alliance. It is not possible for the Alliance to constrain growth or impose excessive pricing on the Auckland- Beijing route as passengers would simply switch to these one-stop options. As demonstrated in 3.16 and 3.17 above, average fares of Alliance's Beijing services (across all cabin classes) have declined over the course of the Alliance period and capacity has increased. The MOT's concern that the Alliance could reduce the prospects of lower fares being offered to passengers on the Beijing service has not eventuated

Table 5: Share Estimates for Beijing – New Zealand

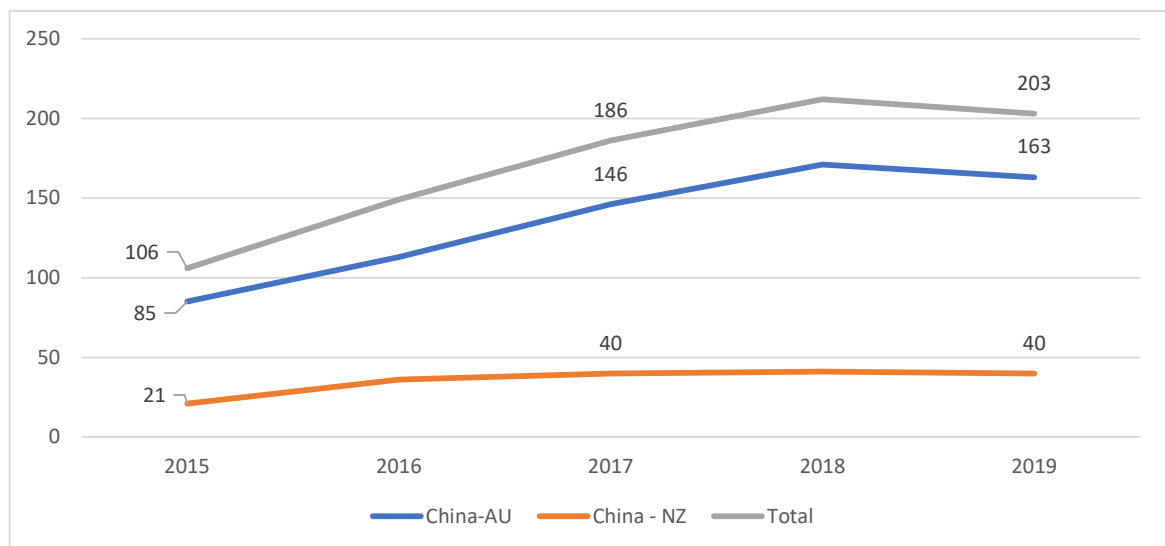
Source: Stats NZ via Air NZ database

[REDACTED]

Entry and Expansion between China – Australasia

- 4.13 In addition to the rapid entry and expansion in direct services to New Zealand, there has been a substantial increase in the number of frequencies operated by carriers between Australia and China over the course of the Alliance.
- 4.14 This has led to a doubling of total frequencies between China and Australasia in 2019 compared to the year prior to the Alliance (see Figure 9 below). Given approximately 30% of the inbound traffic to New Zealand from China still arrives via Australia, the Alliance faces significant competitive constraint from each one of the carriers operating frequencies between China and Australia (as well as China and New Zealand).

Figure 9: Frequency of flights operated between China and Australasia during period of authorisation



- 4.15 The increase in frequencies has been driven by the entry of new Chinese carriers as well as rapid expansion by existing Chinese carriers. As detailed below, six new Chinese carriers launched services to Australasia since the date of authorisation:
- Sichuan Airlines (launched services between Chengdu and Auckland in June 2017);
 - Hainan Airlines (launched services between Shenzhen and Auckland in January 2017 as well as between several Australian ports to Xiamen, Shenzhen and Haikou);
 - Tianjin Airlines (launched services between Auckland and Chongqing in January 2017 (since suspended) as well as services between Melbourne and Chongqing and Sydney and Zhengzhou);
 - Donghai Airlines (launched services between Darwin and Shenzhen);
 - Xiamen Airlines (launched services between Sydney and Xiamen and Fuzhou as well as between Melbourne and Xiamen and Hangzhou); and
 - Beijing Capital Airlines (launched services to Melbourne and Sydney from Qingdao)
- 4.16 There has also been rapid expansion by existing carriers – particularly by China Southern and China Eastern who now make up over half of all frequencies between China and Australasia:

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- (a) China Southern launched services to Christchurch, Adelaide, Cairns, Gold Coast, Melbourne (from Shenzhen), Sydney (from Shenzhen);
 - (b) China Eastern has launched services to Brisbane, Sydney (from Kunming, Wuhan and Haikou);
 - (c) Qantas has launched services between Beijing and Sydney (although Qantas has recently announced it will suspend this service due to Coronavirus, among other reasons) and JetStar launched services between Melbourne and Chongqing.
- 4.17 The extent of new entry and expansion since authorisation demonstrates how competitive the China - Australasian market is. Prior to the outbreak of COVID-19, there were 10 other carriers operating direct services between China and Australasia (12 including Air New Zealand and Air China).

5. THE ALLIANCE HAS RESULTED IN A SUBSTANTIAL NET BENEFIT TO NEW ZEALAND

- 5.1 As the above demonstrates, the Alliance has generated significant public benefits and there has been no detriment to competition arising from the Alliance. Therefore, even if the MOT considers that some of the benefits have not materialised as expected, the Alliance has still resulted in a substantial net benefit to New Zealand.

6. NO LEGAL REASONS FOR THE MINISTER REFUSING TO AUTHORISE THE ALLIANCE

No Legal Reasons for the Minister Refusing to Authorise the Alliance

- 6.1 Sections 88(3) and (4) of the CAA provide specific reasons for the Minister to decline to authorise, although they are subject to an override in section 88(5) if the Minister believes that to decline authorisation would have an undesirable effect on international comity. For the reasons set out in the Applicant's 2015 application, none of the reasons set out in sections 88(3) and (4) apply in respect of the Alliance.
- 6.2 The 2015 MOT Report accepted that the Alliance did not fall foul of any of the prohibitions set out in sections 88(3) and 88(4) of the CAA, and that the agreements were capable of being authorised under the CAA. We do not consider that there have been any material changes to the Alliance that would warrant a change to the conclusions in the MOT Report.

No infringement of section 88(3)

- 6.3 Nothing has occurred in the period since authorisation which should cause the MOT to depart from its earlier view that authorisation of the Alliance is consistent with the relevant arrangements in section 88(3) and the arrangements will not prejudice compliance with any relevant international convention, agreement, or arrangement to which the Government of New Zealand is a party.

International comity

- 6.4 The Applicants remain of the view that declining authorisation would have an undesirable effect on international comity between New Zealand and China and as a result, international comity provides a distinct reason for the Minister to exercise his discretion in favour of authorising the Alliance. This is all the more so in the current environment as countries around the world look to support and rebuild their aviation and tourism industries in the face of COVID-19.

Air New Zealand

30 June 2020