

Air New Zealand / Singapore Airlines Alliance 2018 Reauthorisation

Reason for this briefing	Air New Zealand and Singapore Airlines (the Applicants) have applied for the reauthorisation of their airline alliance. This briefing provides our initial advice on the proposal and seeks your agreement for officials to negotiate the duration of any such reauthorisation.
Action required	Agree that officials contact the Applicants and ask for their agreement that reauthorisation be limited to a period of five years.
Deadline	7 September 2018.
Reason for deadline	The current authorisation expires on 6 January 2019. The airlines have asked for a decision well in advance of this date, as the decision influences their business planning.

Contact for telephone discussion (if required)

Name	Position	Telephone	First contact
Tom Forster	Manager	022 066 3875	✓
[REDACTED]	[REDACTED]	[REDACTED]	

MINISTER'S COMMENTS:

Date:	31 August 2018	Briefing number:	OC180702
Attention:	Hon Phil Twyford	Security level:	Commercial: In Confidence

Minister of Transport's office actions

- Noted*
 Seen
 Approved
- Needs change*
 Referred to
- Withdrawn*
 Not seen by Minister
 Overtaken by events

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Purpose of report

1. This briefing provides our preliminary advice on an application by Air New Zealand and Singapore Airlines (the Applicants) for reauthorisation of their airline alliance, under their Strategic Alliance Agreement (the Alliance).
2. The Applicants are currently working under the Alliance, which was first approved by the Minister of Transport in 2014 and falls due for reauthorisation in January 2019.
3. Our preliminary advice is that the Alliance should be reauthorised, but that the term of this reauthorisation should be limited to a period of five years, rather than the seven years the Applicants have asked for. We are seeking your agreement to discuss the term of this reauthorisation with the Applicants.
4. This briefing will be followed by a more detailed final report, which we will provide to your office in late September 2018.

Summary

5. We believe there are public benefits in the Alliance. It has provided greater international airline capacity (number of seats and flights) into New Zealand and improved connectivity for passengers travelling between New Zealand and key markets in Europe, India and Southeast Asia.
6. There are risks that alliances can reduce competition in some markets, however, we consider that in this case these risks are outweighed by the public benefits described above.
7. Christchurch Airport has concerns regarding the Alliance, noting the Applicants have provided capacity growth at Auckland Airport, with little growth on Christchurch – Singapore services. However, we consider that declining to reauthorise the Alliance is not likely to increase capacity on the Christchurch – Singapore route.
8. If you choose to reauthorise the Alliance, we advise this should be for a period of five years. This will allow us to reassess the Alliance at an appropriate time, and matches what has been provided under similar alliance reauthorisations (such as Qantas/Emirates, which you reauthorised earlier in the year).

Background on alliances

9. International aviation is governed by a network of thousands of bilateral air services agreements. These agreements often restrict the destinations airlines are able to serve and the capacity (number of seats or flights) they are able to provide. Many of these agreements also require airlines to be majority owned by nationals of their home state. This makes it difficult for airlines to merge or establish joint ventures in the same way that most other businesses can.
10. No single airline can operate every possible route in the world. But with alliance arrangements, airlines can expand their reach by effectively combining their networks.
11. In order to overcome the restrictions imposed in bilateral air services agreements, and the inability to serve all routes with their own aircraft, airlines have developed several means of working with one another to expand their global reach. Cooperation between airlines generally takes a number of forms.

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- Interline arrangement: where one airline buys tickets for travel on another airline at a pre-determined price. This is the mechanism through which (for example) Qantas is able to sell its passengers a ticket from Melbourne to Invercargill via Christchurch, even though it does not operate a service from Christchurch to Invercargill.
 - Code-share arrangement: an agreement through which an airline is effectively given the ability to sell seats on flights operated by another airline as if it were operating that flight with its own aircraft. Code-share agreements are relatively common and, without additional cooperation, rarely raise competition issues.
 - Revenue-sharing alliance: an extensive commercial agreement in which two or more airlines agree to share revenue in one or more markets and to cooperate on all aspects of pricing, scheduling and service delivery. These arrangements are generally subject to a much higher level of regulatory scrutiny as they have the potential to reduce competition. The Air New Zealand/Singapore Airlines Alliance is a revenue sharing alliance.
 - Global airline alliance: many airlines are members of one of the three global alliance groups – Star, Oneworld and Skyteam. Members of global alliances work together to provide services to consumers, by cooperating in areas such as marketing, scheduling, ticketing, and frequent flyer schemes. The level of cooperation differs between members, however, it is common for members of the same group to enter into interline and code-share agreements with one another. The Applicants are both part of the Star Alliance.
12. Alliances can result in benefits to consumers, for example, better access to connecting flights, more choices of routes, and the ability to earn and redeem frequent flyer points across the networks of all participating airlines. Alliances also have the potential to reduce costs for airlines, which in competitive markets, results in lower airfares for consumers.
13. However, if alliances reduce or eliminate competition in a market, this can lead to higher airfares or reduced services.
14. In principle, we have taken the view that alliances are a necessary tool for airlines (particularly those with small and remote home markets, such as Air New Zealand) to overcome restrictions imposed on them by bilateral air services agreements and to compete on a global scale. However, each alliance agreement should be carefully scrutinised to ensure it delivers benefits that counteract any negative impacts that may result from a reduction in competition.

The Alliance

15. The Alliance was first authorised by the then Minister of Transport in 2014. Initial authorisation was for a period of four years. Continuation of the Alliance was subject to the Applicants seeking reauthorisation four years after the date of commencement. This falls due on 6 January 2019.
16. Under the Alliance, the Applicants coordinate their operations between Singapore and New Zealand, and on certain services beyond these points. The Alliance allows for varying levels of cooperation between the Applicants on:
- **Alliance Sectors** operating directly between Singapore and New Zealand (currently Auckland – Singapore, Wellington – Singapore and Christchurch – Singapore). Cooperation on direct services between Singapore and New Zealand includes revenue sharing, network planning, codesharing, coordinating operational requirements, capacity and pricing coordination.

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- **Alliance Routes**, which comprise a direct service between Singapore and New Zealand as part of a connecting journey. Cooperation on these services differs depending on the jurisdiction in which the route originates/concludes. On Alliance Routes to priority markets¹, the Applicants code-share and coordinate pricing, sales and marketing. The extent to which the Applicants cooperate in these jurisdictions is limited to what may be allowed by the regulatory authorities in those countries.
17. The Alliance also allows for varying levels of cooperation between Air New Zealand and Singapore Airlines' wholly owned subsidiary SilkAir. SilkAir operates short to medium haul regional services from Singapore.
18. A number of agreements support the Alliance. These include a:
- **Code-Share Agreement** to expand the Applicants' existing code-share arrangements. The Code-Share Agreement covers both Alliance Routes, as well as other countries which either party operates to.
 - **Special Prorate Agreement** to enhance the Applicants' existing special prorate agreement, and set proportional rates, or "prorates" on such routes as the Applicants may agree² on their respective networks.
 - **Premium Customer Handling and Lounge Agreement** to enhance the Applicants' existing arrangements to provide reciprocal premium handling, including lounge access to the extent practical.
 - **Frequent Flyer Programme (FFP) Agreement** to enhance the Applicants' existing frequent flyer programme agreements to the extent practical, including extending FFP arrangements to the SilkAir network.
 - **Slot Transfer Agreement** to set out the arrangements by which the Applicants shall exchange the relevant take-off and landing time slots in order to facilitate operations on Alliance Sectors by Air New Zealand.
19. Of the implementing agreements mentioned above, the Applicants have only requested authorisation of the code-share agreement.

Authorisation is under section 88 of the Civil Aviation Act

20. The Applicants have requested authorisation of the Alliance and supporting code-share agreement under section 88 of the Civil Aviation Act 1990. The effect of authorisation under this section is that the arrangements under the Alliance are exempt from the provisions of the Commerce Act 1986 that prohibit arrangements substantially lessening competition.
21. Section 88 sets out a number of statutory pre-conditions that must be met before authorisation is granted. We have determined the application for reauthorisation meets these conditions. A full analysis of how the provisions in the Alliance relate to each of the section 88 pre-conditions will be provided in our final report.

¹ These are markets that are expected to be primary drivers of traffic and include New Zealand, Singapore, the United Kingdom, Germany, India, Indonesia, Malaysia, Thailand, Viet Nam, the Philippines and South Africa (Priority 1); France, Italy, the Netherlands and Switzerland (Priority 2); Denmark and Spain (Priority 3).

² In other words, an agreement setting out the rates the two airlines will charge each other for seats on one or more legs of the flights they operate.

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22. [REDACTED] In making your decision, you may consider whether authorisation is in the public interest.

Public benefits of the Alliance

23. We consider the main public benefits of the Alliance are increased international capacity and improved connectivity for passengers travelling to and from New Zealand.

Increased international capacity

24. The Applicants note the Alliance has resulted in increased international capacity. Since October 2014, capacity has increased 26% on the Auckland – Singapore route. This has occurred through:
- upgrading the Singapore Airlines Boeing 777 service (278 seats) to an A380 (471 seats) in the Northern Winter season
 - replacing the Singapore Airlines Boeing 777 service (271 seats) with an Air New Zealand Boeing 787 service (302 seats)
 - increasing the frequency of the above service from 5x/7x (peak) per week, to a year-round daily service.
25. In addition to the above, in November 2018 Air New Zealand will commence a new Auckland – Singapore service, using its Boeing 787 aircraft. The new service will operate daily during the November – March peak period, and five times a week during the rest of the year. It will contribute 40% additional seats on the Auckland – Singapore route.
26. Alliance capacity has also been added in Wellington, with the introduction of the Wellington – Singapore service [REDACTED]
27. It is likely the Alliance has had a positive effect on New Zealand's international airline capacity. The cooperative benefits provided by the Alliance have likely allowed the Applicants to grow their services between Singapore and New Zealand in an economically sustainable way. This capacity is beneficial for New Zealand as it increases the availability of services to and from New Zealand, and provides more options for consumers.

Improved connectivity

28. As an "end of line" carrier, which relies primarily on point-to-point traffic, Air New Zealand faces challenges in growing and sustaining its international network. While larger mid-point carriers (including Singapore Airlines) are able to act as global transit points, aggregating passengers from many origins.
29. Partnering with Singapore Airlines allows Air New Zealand to leverage off Singapore Airlines' large international network, to access locations which it could not otherwise serve. For instance, the Alliance allows an Air New Zealand customer to buy a ticket from Auckland to the Sri Lankan capital of Colombo, code-sharing on Singapore Airlines between Colombo and Singapore, while providing a range of either Air New Zealand or Singapore Airlines connecting flights to Singapore.
30. For Singapore Airlines, the Alliance provides greater access to Air New Zealand's domestic network to provide better reach into New Zealand towns and cities, and increase passenger feed into its broader network. The Alliance also allows Singapore Airlines to access points beyond New Zealand, such as code-sharing on services to and from the Pacific.

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31. The Applicants note the Alliance has provided for 120 code-share combinations made available through the underlying Code-Share Agreement. For Air New Zealand in particular, the Alliance increases its ability to reach all of Southeast Asia and Northern Asia on a daily basis, through a route network that it would be unable to replicate, absent the Alliance.
32. These commercial benefits flow through to consumers. The Applicants are able to coordinate their operations so that connections between New Zealand and Singapore Airlines' large international network are efficient in terms of timing and, assuming a competitive market, price.
33. Connectivity is likely to improve further when Air New Zealand begins operating the new Auckland – Singapore flight in November 2018. With the new service, the Applicants have agreed to re-schedule existing services to ensure the Alliance will connect into three different banks of connecting services at Singapore. The Applicants note that this coordination will result in shorter northbound and southbound connections across Southeast Asian, Indian and European services.

Public detriments and risks

Potential for decreased competition on overlapping routes

34. Alliances can negatively impact consumer welfare where cooperation by airlines reduces competition in a particular market. This can occur when both airlines were previously competing with each other on the same 'overlapping' route, and cease to do so under an alliance.
35. The networks of the Applicants are largely complementary and contain only a few overlaps. On these overlaps, there is a risk that the Alliance is negatively affecting competition, by effectively removing one competitor from the market. We have analysed each of the markets where these overlaps exist. In each case, we believe it is unlikely that the Alliance has a material detrimental effect on consumer welfare, as sufficient competition remains from other airlines.
36. The only route where the Applicants have a clear opportunity to exercise market power is the Singapore – Auckland route. In this case, the Applicants are the only airlines offering direct services and there is little competition from other airlines. However, we note that Air New Zealand only began operating this service as a by-product of the Alliance, having previously exited the route in 2006 due to sustained losses. Without the Alliance, we consider it likely that Air New Zealand would exit the route, and Singapore Airlines would continue to be the only airline offering direct services.

Effect on other airlines

37. When first assessing the Alliance in 2014, we noted the Alliance would strengthen the competitive position of Singapore Airlines and Air New Zealand, noting: "*it is likely to draw passenger traffic away from competing airlines, particularly Malaysia Airlines and Thai Airways, which offer a similar product to Singapore Airlines*". We were concerned that this would have been a catalyst for those airlines to exit the New Zealand market, or reduce services.
38. Those concerns do not seem to have eventuated. We note that both Thai Airways and Malaysia Airlines have slightly increased capacity into New Zealand since the Alliance was authorised. We have also seen the entry of other Southeast Asian airlines such as Philippine Airlines and AirAsia X.

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Exclusivity provisions

39. Typically, alliance agreements include exclusivity provisions which prevent the airlines from entering into similar arrangements with other airlines on the same routes. These provisions are designed to protect the integrity of the Alliance, and provide assurances that both airlines are committed to the Alliance.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

43. Our concerns regarding the exclusivity provisions remain. [REDACTED]
[REDACTED]
[REDACTED] For example, Air New Zealand began offering seasonal services to Ho Chi Minh City in 2016. It also announced services to Manila in November 2015 (however these plans were cancelled after it could not receive the necessary regulatory approvals from the Philippines Government). These examples seem to indicate that the provisions have not prevented Air New Zealand from operating services outside the Alliance, where sufficient demand exists.

Stakeholder views

44. The Ministry consulted on the proposed reauthorisation of the Alliance on 12 February 2018. Submissions were received from Tourism New Zealand, the Tourism Industry Association (TIA), Auckland International Airport and Christchurch International Airport. A short summary of these submissions is provided below.

Tourism New Zealand

45. Tourism New Zealand submitted a letter in support of the proposed reauthorisation of the Alliance. It noted that the Alliance has strengthened air connectivity between Singapore and New Zealand, and has deepened New Zealand's connection to Southeast Asia.

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46. Tourism New Zealand mentioned that over the period of the Alliance, New Zealand has seen considerable growth from markets across Southeast Asia and India. It considers these priority markets, as key holiday periods across these markets align with the New Zealand low and shoulder seasons.
47. Tourism New Zealand considers that reauthorisation of the Alliance will continue to deliver stability of services in markets where otherwise carriers would have to respond to demand fluctuations. This stability allows Tourism New Zealand to make investment decisions in alignment with this long term partnership, to deliver long term tourism growth for New Zealand.

Tourism Industry Association

48. Like Tourism New Zealand, TIA also provided a letter in support of the Alliance. It views Asia as an important regional market for New Zealand, and expects it to become even more important. TIA noted Singapore has become an important visitor market for New Zealand, and expressed concern regarding Air New Zealand's claim that it would pull out of the route if the authorisation were declined.
49. TIA mentioned that consideration should be given to what the Alliance will bring to New Zealand more widely. It believes that the South Island is being under-served by international air services compared with Auckland. TIA believes that the Alliance supports the Christchurch-Singapore route and brings increased traffic flows to and through Christchurch.

Auckland International Airport

50. In its submission, Auckland Airport noted it supports market structure arrangements that are consistent with fair and balanced competition, and which provide clear benefits for travellers.
51. Based on its own analysis, Auckland Airport has not seen any behaviour under the Alliance that would cause it concern. The Airport notes that in part, this is because sufficient competitive restraint exists on surrounding routes such that consumers travelling to/from Auckland have adequate alternative airline options when travelling to/from the connecting markets beyond the Singapore hub.

Christchurch International Airport

52. Christchurch Airport notes that it is broadly supportive of airline alliances which, following a rigorous evaluation by the Ministry of Transport and key industry stakeholders, can demonstrate the public benefits outweigh any public detriment.
53. Christchurch Airport highlighted concerns regarding the Alliance, which are discussed below.

Asymmetric capacity

54. Christchurch Airport is concerned that the Alliance is not delivering symmetrical benefits to New Zealand air connectivity. It notes that capacity on the Auckland-Singapore route has increased 30% from 368,232 annual seats in 2014 to 480,264 annual seats in 2017. Meanwhile, capacity on the Christchurch-Singapore route has remained relatively flat at 209,063 annual seats in 2014 to 216,800 annual seats in 2017.

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55. [REDACTED]
56. When the Alliance was first assessed in 2014, we were unsure how it might affect services to airports other than Auckland. We noted that Air New Zealand has incentives to direct as much traffic as possible through its Auckland hub, leveraging its strong domestic network to pool passengers from various points of origin around New Zealand. Under the Alliance, Singapore Airlines is given access to this domestic network, and therefore may have less incentive to operate flights from airports other than Auckland.
57. In particular, stakeholders [REDACTED], were concerned about the effect the Alliance might have on the Christchurch – Singapore route, noting Christchurch is an important gateway for tourism in the South Island. These concerns prompted the Applicants to agree to maintain at least seven services per week on the Christchurch-Singapore route, except in the case of material adverse change in market conditions or other exceptional circumstances. This text was included as an amendment to the Alliance in August 2014.
58. We agree it is important that travellers to and from New Zealand have options in terms of airports of arrival and departure. More options reduce the number of passengers that require extra domestic legs to their international itineraries, saving these passengers both time and the cost of extra travel.
59. However, we do not believe that declining to authorise the Alliance will lead to better dispersal of international airline capacity within New Zealand. [REDACTED]

Alliance conditions

60. In its submission, Christchurch Airport has suggested that for the Alliance to be in the public interest, conditions would need to be imposed by the Minister, or assumed voluntarily by the Airlines, to ensure the public benefits claimed are delivered. Christchurch Airport has not elaborated on what these conditions might be, however they are likely to be referring to conditions which would require the Applicants to maintain a certain number of flights on particular routes.
61. In most cases, we consider these types of conditions as inappropriate, for the following reasons:

[REDACTED]

³ Air New Zealand currently holds alliances with Air China, United Airlines, Cathay Pacific and Virgin Australia (which ends in October 2018).

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- [REDACTED]
- Route-specific capacity conditions risk creating market distortions. There is significant risk from a regulatory perspective of requiring capacity to be added on routes where it exceeds passenger demand, which in turn may prevent capacity from being added on routes where demand is strong.

62. Noting the above risks, we consider that in the case of this Alliance, there are no good reasons for you to impose capacity conditions, over and above what is already provided for in the Alliance (see paragraph 57).

Term

63. The Applicants have applied for reauthorisation of the Alliance for a further term of seven years. This is longer than what is usually provided for under similar alliances and longer than the four-year period for which the Alliance was initially authorised.

64. The Applicants state that reauthorising the Alliance for a longer seven-year term reflects the benefits which the Alliance has provided to New Zealand, and will provide the Applicants with sufficient certainty and confidence to implement and promote additional capacity.

65. We believe the Applicants have not provided any special reasons why the Alliance should be reauthorised for a seven-year period. We consider a term of five years to be more appropriate. This allows for the reassessment of the Alliance after an appropriate interval, while also providing sufficient certainty for the Applicants to plan and implement their operations under the Alliance.

66. [REDACTED] you may decline to authorise any application that does not include an appropriate time limit. Should you agree with our recommendation, we would discuss the five-year time limit with Air New Zealand and suggest that they consider conferring with Singapore Airlines and amend the application accordingly.

67. The Applicants are likely to interpret our conversation regarding term as an indication that we will recommend reauthorisation of the Alliance. However, this does not tie you to making a decision to reauthorise, when our final advice is provided in late September.

Next steps

68. Officials are currently working on a comprehensive report, which contains our detailed analysis and final recommendation concerning the proposed reauthorisation. We will provide this to your office in late September, and ask for your decision at this time.

69. In the meantime, subject to your agreement, we will contact the Applicants and ask for their agreement that any such authorisation shall be limited to a period of five years. We will report back to you on this when providing our final advice.

70. Officials are available to discuss the authorisation should you require it.

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Recommendations

71. The recommendations are that you:

- | | | |
|-----|---|--------|
| (a) | authorise officials to discuss the matter of five-year reauthorisation with the Applicants | Yes/No |
| (b) | advise whether you would like to discuss this reauthorisation with officials | Yes/No |

Tom Forster
Manager International Connections

MINISTER'S SIGNATURE:

DATE: