

APPENDIX B

D02/65324

This schedule contains explanations of:

- (a) Freedoms and Bilaterals
- (b) Air Services Arrangements
- (c) Code sharing and the role of the Ministry of Transport
- (d) IATA and international tariff co-ordination
- (e) Airline booking systems
- (f) Airline and Airport Codes
- (g) Aircraft description and availability
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Freedom of the air

1. The regulatory system for international air transport was established by the Convention on International Civil Aviation of December 1944 (the **Chicago Convention**). The Chicago Convention established the framework under which international air transport is regulated. The key concepts in this system are the freedoms of the air.
2. There are nine “freedoms of the air” (**Freedom**s). The first five Freedoms were identified in 1944, as part of the International Air Transport Agreement which 12 states have signed. Freedoms six to nine have subsequently been identified as additional Freedoms.
3. The Freedoms are set out below along with a relevant illustration of how the Freedom would apply in the Australasian aviation market.

First Freedom

4. The First Freedom is the right of an airline of one country to fly over the territory of a foreign country.



5. For example, First Freedom rights would allow Air New Zealand to fly over Australia en route to Asia.

Second Freedom

6. The right of an airline of one country to land in a foreign country for non-traffic (traffic is passengers, cargo or mail) purposes (for example, re-fuelling or maintenance), en route to another foreign country.



7. For example, Second Freedom rights would allow Air New Zealand to land in the United States, re-fuel, and fly on to London, provided it did not pick up or set down passengers, cargo or mail.

Multilateral exchange of freedoms one and two

8. The International Air Services Transit Agreement which came into force on 30 January 1945, provides for the multi-lateral exchange of the first two Freedoms between the 118 parties to the Agreement. The exchange of all other Freedoms (including the first two Freedoms for countries that were not signatories to the Agreement) is negotiated on a bilateral basis and given effect to in bilateral agreements. Efforts to achieve multilateral exchange of the other Freedoms, by way of the International Air Transport Agreement, were essentially unsuccessful.

Third Freedom

9. The right of an airline of one country to carry traffic from its country to a foreign country.



10. For example, a bilateral between New Zealand and Australia that granted Third Freedom rights would allow Air New Zealand to take traffic from Christchurch and deliver it to Sydney.

Fourth Freedom

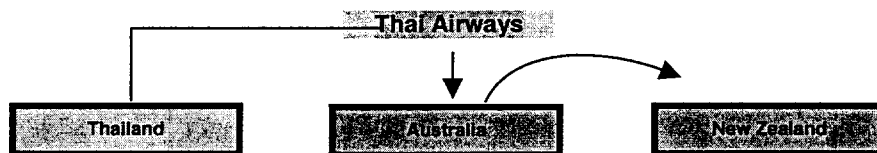
11. The right of an airline to carry traffic from a foreign country to its own country.



12. For example, a bilateral between New Zealand and Australia that granted Fourth Freedom rights would allow Air New Zealand to take traffic from Sydney and deliver it to Wellington.

Fifth Freedom

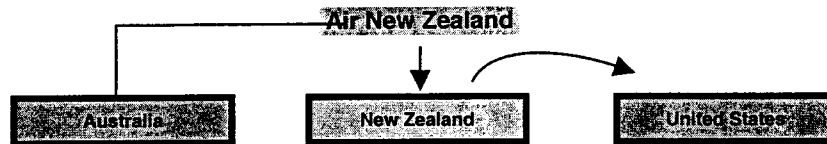
13. The right of an airline of one country to land in a foreign country, pick up and deliver traffic, and then fly to a second foreign country. Fifth Freedom rights are confined to flights that originate or terminate in the airline's home country.



14. For example, Australia and New Zealand's bilateral with Thailand grants Fifth Freedom rights. This allows Thai Airways International (**Thai**) to fly from Bangkok and land in Brisbane, pick up and deliver traffic, and then fly from Brisbane to Auckland. In addition, Fifth Freedom rights allow Thai to do the same in reverse. Accordingly, Thai can fly from Auckland to Brisbane, pick up and deliver passengers and then fly on to Bangkok.
15. Fifth Freedom rights are extremely important in the trans-Tasman market. For example, Thai flies 747's from Bangkok to Australian airports. These flights typically arrive early in the morning. Given the time differences and flying times, in order for Thai's return flights from Australia to Bangkok to connect with evening outgoing flights from Bangkok, Thai's return flights do not leave until late evening. Accordingly, Thai's plane is idle during that period.
16. Fifth Freedom rights allow Thai to utilise the idle plane to fly trans-Tasman routes. Thai can price seats on these trans-Tasman services at close to marginal cost since any revenue received above marginal cost will contribute towards Thai's fixed costs because in the absence of the trans-Tasman service, the aircraft would be idle.

Sixth Freedom

17. The right of an airline of one country to carry traffic between two foreign countries via its own country. Essentially, the Sixth Freedom combines two sets of Third and Fourth Freedoms.



18. For example, a bilateral between New Zealand and Australia, and a bilateral between New Zealand and the United States, that each grant Third and Fourth Freedoms, would allow Air New Zealand to pick up traffic in Sydney, fly to Auckland, and then fly to Los Angeles.

Seventh Freedom

19. The right of an airline of one country to operate flights between two foreign countries without the flight originating or terminating in its own country.



20. For example, bilaterals between New Zealand and Australia and New Zealand and the United States, that granted Seventh Freedom rights allow Air New Zealand to carry traffic directly from Los Angeles to Sydney, without a requirement for that service to operate either through New Zealand, or continue from Sydney to a point in New Zealand.

Eighth Freedom

21. The right of an airline to carry traffic from one point in a foreign country to another point in the same foreign country on a flight originating in the airline's home country.



22. For example, a bilateral between New Zealand and Singapore that granted Eighth Freedom rights would allow Singapore Airlines to carry traffic from Singapore to Christchurch, pick up and deliver traffic, and then fly to Wellington. This carriage of passengers domestically in a country by a foreign airline is known as cabotage.

Ninth Freedom

23. The right for an airline to carry traffic from one point in a foreign country to another point in the same country without a requirement that the flight originates in an airline's home country.



24. For example, a bilateral between New Zealand and Australia that granted Ninth Freedom rights would allow Qantas to fly a route from Auckland to Wellington to Christchurch.

Air Services Arrangements

Introduction

1. The regulatory system for international air transport was established by the Convention on International Civil Aviation of December 1944 (the **Chicago Convention**). The Chicago Convention enshrined the principal that each country has exclusive sovereignty over its own airspace. Unlike most other forms of international trade and transport, which are generally unrestricted unless specifically restricted, international air transport cannot occur unless it is specifically authorised. Efforts in 1944 to develop a multilateral agreement providing for open access to markets were essentially unsuccessful.

Bilaterals

2. International air transport can be specifically authorised, and most commonly is, by two states entering into an arrangement to allow international air transport (a **bilateral**).
3. Bilaterals are premised on reciprocal rights. That is, in a bilateral between country A and country B, country A's designated airlines should have the same access to country B's market as country B's designated airlines have to country A's market. Bilaterals generally comprise an Air Service Agreement, providing the overall framework, and associated documents detailing the operational mechanics of the arrangements between the governments of the two party countries.
4. The precise form of a bilateral agreement will depend on the negotiations between the two party countries. However, some common features of bilateral agreements in the past have included:
 - market access provisions (for example, which Freedoms are granted, and which routes are included (see Schedule 3(a) for an explanation of Freedoms);
 - capacity and frequency provisions;
 - a method for determining or approving tariffs; and
 - provision for country A to withhold operating rights from a designated airline of country B if that airline can not demonstrate that it is substantially owned and effectively controlled by nationals of country B.

5. This last requirement is important. There is no international definition of what “substantially owned and effectively controlled” means. This requirement entrenches the bilateral negotiation system by preventing an airline from country C gaining a substantial interest in an airline from country A, and thereby enabling it to take advantage of market opportunities in the bilateral agreement between countries A and B.

Multilateral Air Services Arrangements

6. International air transport can also be specifically authorised by numerous states entering into a single arrangement to allow international air transport between each other (a multilateral air services arrangement).
7. As discussed above, efforts for a multilateral arrangement for open access were unsuccessful in 1944. However, on 21 December 2001 the Multilateral Agreement on the Liberalization of International Air Transportation (**MALIAT**) entered into force. New Zealand, United States, Singapore, Samoa, Brunei, Chile and Peru are all parties of MALIAT. In essence MALIAT is an “Open Skies” arrangement (see below for an explanation).

New Zealand's Air Service Arrangements

8. A summary of New Zealand's existing Air Service Arrangements relevant to this application is included in this Application as Schedule [9].

Open Skies Arrangements

9. An open skies arrangement (**Open Skies**) is a form of liberal air services arrangement between states, most commonly in a bilateral format. The purpose of Open Skies is to remove most traffic and market access constraints as well as reducing the extent of government involvement in the aviation industry.
10. Although there is no uniform definition of Open Skies and the precise provisions of Open Skies vary from arrangement to arrangement, it generally involves the removal of restrictions and access to each country's markets, including unlimited rights to intermediate and beyond points. Restrictions on capacity and frequency, ability to codeshare and routes (including points of access) are also removed. However, restrictions often remain on foreign ownership and control of designated airlines, ability to operate domestic flights in the other country (cabotage) and, in some cases, the ability to fly from the other country to a third country (Fifth Freedom).

11. The open skies "movement" gathered pace in 1994, following the United States' initial open skies bilateral with the Netherlands in 1992. The Open Skies that the United States generally enters into provides for open entry on all routes between the bilateral partners, unrestricted rights to operate between any international gateways in the United States and participating countries, unrestricted capacity, frequency and aircraft on all routes and allows flexibility in setting fares. However, United States does not grant cabotage and is generally unwilling to relax the restrictions on foreign ownership. There is the possibility that the US position may be relaxed in the context of a negotiation with the EU.

12. The Open Skies agreements that New Zealand enters into with other nations are based on the United States model. However, New Zealand's model includes more liberal terms than those acceptable to the United States, such as the inclusion of passenger and cargo seventh freedom and cabotage rights and New Zealand prefers a formulation based on the principal place of business, place of incorporation, and effective control in the country or nationals of that country).

Codesharing and the role of the Ministry of Transport

What is codesharing?

1. IATA assigns each airline a designator code, which is used to identify that airline within schedules. For example, Air New Zealand's IATA assigned designator code is NZ. A particular flight is identified in a schedule according to the designator code of the airline providing the service and by the flight number assigned to that flight by the airline. For example, Air New Zealand's Wednesday 6:45 a.m. flight from Christchurch to Sydney is identified by the code NZ181. NZ is Air New Zealand's designator code, while 181 is the flight number assigned to that flight by Air New Zealand.
2. Codesharing involves an airline assigning its own designator code to a flight operated by another airline. The essence of a codeshare is that two or more airlines can each sell seats on the same flight with each airline using its own designator code and flight number to identify that flight in the schedule.
3. For example, a codeshare on the Christchurch to Sydney route between Qantas and Air New Zealand would allow Qantas to assign its designator code (QF) and to assign a flight number to Air New Zealand flight NZ181. Qantas could then sell tickets on NZ181 as if NZ181 was a Qantas flight. That is, a passenger could choose to purchase a ticket for a Wednesday 6:45a.m. flight from Christchurch to Sydney on either flight NZ181 or flight QF391, even though these two services are operated using the same aircraft.

Types of codesharing

4. A common way in which a codeshare is executed is through a blocked space agreement. Under a blocked space codeshare, an airline (for example, Qantas) buys a certain amount of seats on another airline's flight (for example, on Air New Zealand's NZ181). Qantas then markets and sells the seats it has purchased on NZ181 as if the seats were on a Qantas plane.
5. Alternatively, airlines may codeshare on a freesell basis. Under a freesell codeshare there is no arrangement for an airline to buy a certain amount of seats on another airline. Instead an airline (for example Qantas) simply sells part the inventory of another airline (for example Air New Zealand).

Motivation for codesharing

6. The key driver for airlines to use codeshares is that codeshares provide a cost-effective method of adding to an airline's network. Using the example above, through codesharing, Qantas obtains a presence on the Christchurch to Sydney route without having to incur the costs of actually flying an aircraft on that route.
7. In addition, the role that the CRS plays in marketing an airline's services is a key driver for airlines to establish codeshares. Where passengers must stop off during a flight (for example, on Air New Zealand's flights from Auckland to London via the United States, a stop-off is required at Los Angeles) passengers prefer to connect with a flight operated by the same carrier (an **online connection**). The CRS system recognises this passenger preference and gives priority to online connecting flights over other connecting flights. Codesharing allows an airline to ticket codeshared connecting flights as if they were its own flights and, accordingly, allows that service to appear as an online connection in the CRS system.

Role of the Minister of Transport

8. Section 88(2) of the Civil Aviation Act 1990 (the **Civil Aviation Act**) provides:

“The Minister [of Transport] may from time to time specifically authorise all or any provisions of a contract, arrangement, or understanding made between 2 or more persons in respect of international carriage by air and related to such carriage so far as the provisions relate, whether directly or indirectly, to the fixing of tariffs, application of tariffs, or the fixing of capacity, or any combination thereof.”
9. Pursuant to this section, the Minister of Transport (the **Minister**) has the discretion to authorise arrangements involving the carriage by air of persons, cargo and mail:
 - (a) between New Zealand and any place outside New Zealand; and
 - (b) between places outside New Zealand if that carriage is purchased, sold or arranged in New Zealand.
10. The Minister has the discretion to authorise codeshares under section 88(2). In exercising this discretion, the Minister receives advice from the Air Services [Section/Group] of the Ministry of Transport. Sections 88(3) and 88(4) specify considerations that the Minister must have regard to when deciding whether to exercise his discretion whether or not to grant an authorisation.

11. Section 88(3) concerns ensuring that New Zealand complies with its obligations under the international aviation conventions and agreements to which New Zealand is a party.
12. Section 88(4) sets out the competition law concerns that the Minister is directed to consider in determining whether or not to exercise his discretion to grant an authorisation.
13. Section 88(3) and section 88(4) are set out below.

Section 88(3)

14. Section 88(3) provides:

“In considering whether to grant authorisation under sub section (2) of this section, the Minister shall ensure that the granting of such authorisation will not prejudice compliance with any relevant international convention, agreement, or arrangement to which the Government of New Zealand is a party.”

15. As part of his consideration under section 88(3) the Minister will consider the impact of the contract, arrangement or understanding on New Zealand’s obligations under existing bilateral Air Service Agreements.

Section 88(4)

16. As stated above, section 88(4) details the competition law concerns that the Minister is directed to consider in determining whether or not to exercise his discretion to grant an authorisation. The Minister may not authorise any provision of any contract, arrangement, or understanding, that:
 - provides that any party to it may directly or indirectly enforce it through any form of action by way of fines or market pressures against any person, whether or not that person is a party to the contract, arrangement, or understanding; or
 - has the purpose or effect of breaching the terms of a commission regime issued under section 89 of the Civil Aviation Act; or
 - unjustifiably discriminates between consumers of international air services and the access they have to competitive tariffs; or
 - so far as it relates to tariffs, has the effect of excluding any supplier of international carriage by air from participating in the market to which it relates; or

- has the purpose or effect of preventing any party from seeking approval, in terms of section 90 of the Civil Aviation Act, or the purpose of selling international carriage by air at any other tariff so approved; or
- prevents any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding.

17. However, the Minister must not decline to make an authorisation if such an action would have an undesirable effect on international comity between New Zealand and another state. This saving provision is discussed below.

Saving where to decline authorisation would have an undesirable effect on international comity between New Zealand and another state.

18. If the Minister declines to authorise on the grounds that the contract, arrangement or understanding would breach section 88(4), section 88(5) of the Civil Aviation Act empowers the Minister to authorise the contract, arrangement or understanding if refusal to authorise would have an undesirable effect on international comity between New Zealand and another state. Section 88(5) provides:

“Notwithstanding the provisions of subsection (4) of this section, the Minister may authorise any provision of any contract, arrangement, or understanding under this section if the Minister believes that to decline authorisation would have an undesirable effect on international comity between New Zealand and any other State”.

Application of the Commerce Act 1986

19. Section 91(1) provides that sections 27 to 29 of the Commerce Act do not apply to negotiating and concluding tariff or capacity fixing arrangements under section 88. Section 91(2) provides that Ministerial Authorisations under section 88 are specific authorisations for the purposes of section 43 of the Commerce Act. Section 43 of the Commerce Act 1986 provides that nothing in Part II of the Commerce Act relating to restrictive trade practices applies to any matter that is specifically authorised by any other enactment.
20. The Civil Aviation Act’s approach is to specify certain matters the Minister *shall* have regard to. However, there is no express limitation on the matters which the Minister *may* have regard to. Accordingly, it is arguable whether section 88 is a code insofar as it identifies the specific competition law concerns the Minister is permitted to have regard to when exercising his discretion.

21. While not made explicitly clear, interpreting the Civil Aviation Act as a whole, it appears that Parliament intended to exempt international air carriage from the application of the competition law policy considerations under the Commerce Act 1986, replacing them with the more limited (and codified) regime in the form of the six specified matters in section 88(4).
22. Accordingly, in the Applicant's view, the Minister must exercise his discretion under section 88(2) in accordance with the Civil Aviation Act. The Minister can only decline to grant an authorisation under section 88(2) if (at least) one of the reasons set out in section 88(3) or section 88(4) is established.

IATA and international tariff co-ordination

1. The International Air Transport Association (**IATA**) is a non-governmental industry body, incorporated in Canada, that represents the interests of its approximately 280 airline members. “Active” members of IATA must provide international air service for the public transport of passengers, mail or cargo by aircraft. Non-international airlines can be “associate” members. An associate member can not vote at certain IATA meetings.
2. The member airlines of IATA account for more than 95% of all international scheduled air traffic. Both Air New Zealand and Qantas are members of IATA.
3. IATA serves as the authority and reference point for:
 - (a) passenger, tariff-related issues, and as the forum where fares and rules are established for interlining purposes; and
 - (b) cargo, tariff-related issues and the forum where rates and rules are established for interline purposes.
4. IATA was established in 1945. As noted at Schedule 3(a), regulation of international air transport is premised on each country’s exclusive sovereignty over its own airspace. Governments have exercised sovereignty over their airspace in a number of ways, including overseeing the setting of prices.

“In the early days Governments insisted on the right to oversee the prices charged by international airlines, but they could not, in practical terms, develop those prices for themselves. IATA was delegated to hold Traffic Conferences for this purpose, with all fares and rates subject to final Government approval. The aim was two-fold: to ensure that fares and rates would not involve cut-throat competition, and to ensure that they could be set as low as possible, in the interests of consumers.”²
5. It is from this exercise of Government sovereignty that IATA gained its mandate to co-ordinate prices. During this period, air fares and cargo rates were negotiated at IATA conferences and then those fares were implemented through their incorporation, by Governments, into bilateral air service agreements.

² http://www1.iata.org/about/history_2.htm

6. Deregulation of the airline industry began in the USA in the 1970s and had a profound impact on IATA. The U.S. Government, which had granted IATA traffic conferences immunity from national anti-trust law in 1946, began a review of air transport regulation. IATA was called upon to “show cause” why anti-trust immunity should not be removed from its tariff co-ordination activities. IATA’s website, with respect to the United States, notes that “the current position is that all Tariff Coordination activities continue to be protected”.³
7. Prior to deregulation, participation by member airlines in tariff co-ordination was a condition of membership. However, today, participation in tariff co-ordination is optional, with approximately 100 member airlines participating. The focus of IATA’s tariff co-ordination conferences is now on establishing “reference fares”.
8. These “reference fares” are used to facilitate interlining and to determine how revenue from the sale of an interline ticket should be divided between the airlines. Accordingly, the fares negotiated in these conferences are not the fares faced by final consumers. For example, the IATA published fare for flights between Singapore and Auckland is \$SG2,917 (\$NZ3,315) while the Air New Zealand nett level fare is \$SG1,500 (\$NZ1,704). Similarly the IATA published fare for London Heathrow to Auckland is £1374 (\$NZ4,286) while the Air New Zealand nett level fare is £700 (\$NZ2,183). As these examples illustrate, there is no fixing of final consumer fares.

³ http://www1.iata.org/about/history_4.htm

Airline booking systems

1. The booking system for air travel is based around each individual airline's Computerised Reservation System (**CRS**), which contains an airline's flight information, and Global Distribution Systems (**GDSs**), which collate and consolidate the information made available on individual airlines CRSs. CRSs and GDSs are explained below.

CRS

2. Each airline operates its own CRS, which is a computerised booking and ticketing system. Airlines use CRSs to manage their seat inventory, marketing and ticketing processes. Accordingly, CRSs play an important role in an airline's sales methodology and yield management processes (discussed elsewhere in this Schedule at 3(h)). An airline can analyse the likely returns on a particular flight and adjust the number of tickets it makes available in each fare classes on that flight immediately in its CRS.
3. Customers can generally access an airline's CRS, so as to make a booking enquiry, through that airline's website. For example, a customer can ultimately access Air New Zealand's CRS for booking purposes via Air New Zealand's website at www.airnz.co.nz.

GDS

4. A GDS is a tool, provided to travel agents and other licensed users, that allows a user to generate the travel service options available in response to a particular query, for example, all flights from Wellington to Melbourne on 1 December 2002.
5. A GDS works by collating the information contained on the CRSs of various airlines, hotels, rental car companies and tourism service providers. A user can then, using software on his or her desktop computer terminal, have real time access to information on airline flight schedules, seat availability and prices, information on availability and prices of hotel accommodation, information on availability and prices of rental cars, and information on availability and prices of other travel services.
6. The major GDSs are Galileo, Sabre, Amadeus and Worldspan. The owners of each of these GDSs are set out below:
 - (a) Galileo is owned by Cendant Corporation;
 - (b) Sabre is a public company, listed on the New York Stock Exchange;

- (c) Amadeus is a public company, listed on the Madrid, Frankfurt and Paris Stock Exchanges. Founding airlines Air France (23%), Iberia (18%) and Lufthansa (18%), currently hold approximately 59% of the shares in Amadeus; and
- (d) Worldspan is owned by affiliates, Delta (40%), Northwest (34%) and American Airlines (26%).

Airline and Airport Codes

1. This section sets out the codes used in the aviation industry for airlines and airports.

Airlines

2. IATA assigns each airline a designator code pursuant to IATA resolution 762. The designator codes for those airlines that operate services (including codeshare services) in New Zealand and Australia are given in the table below. The airlines that conduct services into or within New Zealand are highlighted in bold.

<i>Code</i>	<i>Airline</i>
AA	American Airlines
AC	Air Canada
AR	Aerolineas Argentinas
BA	British Airways
BI	Royal Brunei
BR	EVA Airways
CA	Air China
CI	China Airlines
CS	Continental Micronesia
CX	Cathay Pacific
CZ	China Southern
DJ	Virgin Blue
EK	Emirates
FJ	Air Pacific Ltd
GA	Garuda Indonesia
IE	Solomon Airlines
JL	Japan Airlines
KE	Korean Air
KL	KLM Royal Dutch Airline

Code	Airline
LA	Lan Chile
LH	Lufthansa (cargo only)
MH	Malaysia Airlines
MS	Egypt Air
NC	Norfolk Jet Express
NF	Air Vanuatu
NG	Lauda Air
NZ	Air New Zealand
OA	Olympic Airways
OZ	Asiana Airlines
PH	Polynesian Airways
PX	Air Niugini
QF	Qantas
QO	Origin Pacific
SA	South African Airlines
SB	Air Calin
SJ	Freedom Air
SQ	Singapore Airlines
TG	Thai Airways
TN	Australian Airlines
UA	United Airlines
VS	Virgin Atlantic
WR	Royal Tongan Airline