

**SUBMISSION ON APPLICATION FOR AUTHORISATION OF THE NORTH ASIA ALLIANCE AGREEMENT BETWEEN AIR NEW ZEALAND AND CATHAY PACIFIC**

25 July 2012

**Introduction**

- 1 Christchurch International Airport Limited (*CIAL*) welcomes the opportunity to submit to the Ministry of Transport (*MOT*) on the application by Air New Zealand Limited (*Air NZ*) and Cathay Pacific Airways Limited (*Cathay*) (together, the *Airlines*) for authorisation under section 88 of the Civil Aviation Act 1990 of the North Asia Alliance Agreement (*NAAA*) and related agreements, including a Code Share Agreement (together, the *NAAA Agreements*).
- 2 *CIAL*'s submission is based on our review of the materials provided by the *MOT*, which includes a redacted version of the application by the *Airlines* and a response by the *Airlines* to questions posed by the *MOT*. We have also been briefed by representatives of *Air NZ* on the key elements of the *NAAA Agreements*.
- 3 *CIAL*'s submission proceeds on the basis that all information relevant to the assessment of the public interest has been disclosed. The disclosure of information by the *MOT* and *Air NZ* is positive, but we note that a number of elements of the *Airlines*' application remain confidential and that the materials provided to us by the *MOT* contain significant redactions. Our submission should be read in this context.

**Key points**

- 4 In general, *CIAL* prefers the maintenance of independence between carriers because that best promotes competition in freight and passenger markets for the long-term benefit of consumers in New Zealand. But we accept that in some limited circumstances a degree of coordination between carriers may be in the public interest.
- 5 In this case, *CIAL* broadly supports the *Airlines*' application for authorisation of the *NAAA Agreements* on the basis of the public benefits outlined by the *Airlines* in their application to the *MOT*. In particular, the alliance proposed by the *Airlines* ensures that the existing service frequency on the Auckland (*AKL*) – Hong Kong (*HKG*) route is maintained. There is a risk that in the counterfactual the existing service frequency may not continue.
- 6 However, if the alliance fails to deliver on the anticipated consumer benefits (such as improved connecting schedules and access to a greater range of competitive fares), or if the independent prospects for the *Airlines* on the *AKL-HKG* route improve, the alliance may no longer be in the public interest.
- 7 For this reason, *CIAL* recommends that the *MOT* authorise the *NAAA Agreements* for the shortest period that is commercially practicable. The *Airlines* would have a period to measure progress against the anticipated benefits and this would allow the *MOT* to assess an application for renewal of the *NAAA Agreements* at the end of the initial period on the basis of hard evidence. In particular, if after three years there is no indication that either airline will expand domestic and international services to

New Zealand markets beyond Auckland, the MOT should consider whether the alliance remains in the public interest.

- 8 With respect to the anticipated consumer benefits, although the NAAA Agreements would provide Asian markets with marginally greater visibility of New Zealand destinations beyond Auckland (like the South Island), through the improved access to interline services, the full benefits of the alliance for these markets will not be realised unless the Airlines:
- 8.1 introduce a direct Air NZ or Cathay air service linking HKG and other points in New Zealand beyond AKL, and add this service to the Code Share Agreement; and
  - 8.2 include Feeder Routes<sup>1</sup> in the Code Share Agreement (subject to the New Zealand/China Air Services Agreement (ASA) being amended to permit onwards code-sharing).
- 9 CIAL would be very concerned if the effect of the NAAA Agreements is to directly or indirectly foreclose or reduce the likelihood of either of these opportunities being exploited in due course.
- 10 The proposal by the Airlines, and particularly the exclusion of Feeder Routes from the Code Share Agreement, highlights deficiencies in the New Zealand/China ASA that the MOT should have regard to when this ASA is reviewed in 2014.

**CIAL broadly supports the application**

- 11 CIAL broadly supports the Airlines' application for authorisation of the NAAA Agreements, for the public interest reasons discussed below at paragraph 13.
- 12 CIAL does not propose to address the specific matters the Minister of Transport is required to consider under section 88 of the Civil Aviation Act 1990, as these matters are adequately dealt with in the Airlines' application.

***Public interest factors***

- 13 CIAL considers that the NAAA Agreements (particularly when counterfactuals are considered) are in New Zealand's public interest because:
- 13.1 the current frequency of service between AKL and HKG is maintained and there is an opportunity for an increase in services, which would stimulate growth in visitors to New Zealand and support wider export and import trade between New Zealand and Asia;
  - 13.2 the presence of both Air NZ and Cathay on the AKL-HKG route (and in the New Zealand-China market) is preserved; and
  - 13.3 access to domestic New Zealand interline services for passengers originating in HKG and beyond is increased, which is an improvement on the status quo and may allow some marginal benefits to be transmitted to New Zealand markets beyond Auckland.

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<sup>1</sup> As defined in the Airlines' application.

***Possible counterfactuals detrimental to public interest***

14 CIAL understands that the Airlines are facing significant pressure from competing services operated by other airlines from the Pearl River Delta region (or substitutable routes) and that potential counterfactuals in the absence of the NAAA Agreements include:

14.1 an overall reduction in the aggregate services between AKL and HKG; or

14.2 the withdrawal of either Airline from the AKL-HKG route.

15 Either of these counterfactuals would clearly be detrimental to New Zealand's interests and, if considered likely, should be relevant for the MOT when assessing the Airlines' application.

**CIAL's support is subject to no reduction in existing services or restrictions on additional services**

16 CIAL's support of the NAAA Agreements is subject to there being no risk that authorisation of the Airlines' proposal will:

16.1 reduce existing services linking New Zealand and Asian markets; or

16.2 prevent additional services being added in future (in particular future services directly servicing the South Island).

17 No evidence of these risks is presented in the materials provided by the MOT to CIAL, or the briefing provided by Air NZ to CIAL.

18 However, CIAL would be particularly concerned with any elements of the NAAA Agreements that could or would act as barriers to:

18.1 establishing additional direct services between HKG and destinations in New Zealand other than AKL; or

18.2 including Feeder Routes in the Code Share Agreement in future (subject to the New Zealand/China ASA permitting this).

**The authorisation should be for a short term**

19 CIAL believes the Airlines' proposed five year term for authorisation of the NAAA Agreements is too long, given the possibility that:

19.1 the Airlines could fail to deliver on their promised consumer benefits (such as improved connecting schedules and access to a greater range of competitive fares); or

19.2 the independent prospects for the Airlines' on the AKL-HKG route could improve.

20 In either of these circumstances, the NAAA Agreements may no longer be in the public interest, and CIAL's view is that the MOT should be able to test whether the alliance does in fact benefit New Zealand without an expansion (either via code share Feeder Routes or direct international flights) to New Zealand markets beyond Auckland.

- 21 For this reason, CIAL recommends that the NAAA Agreements be authorised for a shorter period, at the expiry of which there would a possibility of the authorisation being renewed. Renewal would be granted if the Airlines could provide evidence to the MOT that the NAAA Agreements are, and will continue to be, in the public interest.
- 22 CIAL considers that a three year period for authorisation is optimal to allow:
- 22.1 the Airlines to realise commercial efficiencies from implementing the NAAA Agreements; and
- 22.2 evidence of the anticipated consumer benefits to become apparent.
- 23 Three years is the same period for which the ACCC authorised the comparable proposal by Virgin Blue and Air NZ, which was subsequently endorsed by the MOT in their authorisation of that same proposal.
- 24 Further, after three years, the effects of the MOT's revised International Air Transport Policy on the air services market should become apparent, and the New Zealand/China ASA will have been revisited. This would be an ideal time to reassess market conditions on the AKL-HKG route.

**Insubstantial benefits to other New Zealand markets**

***Optimising interline connections provides no material benefit***

- 25 With respect to the Airlines' anticipated consumer benefits, CIAL notes that the NAAA Agreements currently provide no material benefits to New Zealand markets beyond Auckland, like the South Island.
- 26 While optimising access to New Zealand domestic interline connections is an improvement on the status quo, this improvement is not substantial given the relatively small number of interline connections to New Zealand markets beyond Auckland.
- 27 Compared with CIAL's preferred options of a direct service, or code shares on Feeder Routes, interline services do not materially improve visibility of New Zealand markets beyond Auckland, for Asian visitors.

***Commitments from Airlines that would provide material benefit***

- 28 The NAAA Agreements would materially benefit New Zealand markets beyond Auckland if the Airlines pursued either of the following opportunities:
- 28.1 introducing a direct Air NZ or Cathay service linking HKG and other points in New Zealand in addition to AKL, and adding this air service to the Code Share Agreement (the Airlines' application indicates that the NAAA can accommodate such an expansion, which CIAL welcomes); and
- 28.2 in the longer term, including Feeder Routes in the Code Share Agreement by having a 'CX' abbreviation put on Air NZ flights (subject to the New Zealand/China ASA being amended to permit onwards code-sharing).
- 29 CIAL would be concerned if the NAAA Agreements directly or indirectly foreclosed or reduced the likelihood of either of these opportunities being exploited in due course.

30 In the past CIAL and Cathay have had detailed discussions about the need for better air services to the South Island and, given the significant potential volumes of traffic to and from the South Island from Asia, CIAL encourages the Airlines to leverage the advantages of the NAAA Agreements by committing to pursuing these stated opportunities.

***Current ASA is a barrier to accessing the South Island***

31 As CIAL noted in its recent submission to the MOT on New Zealand's International Air Transport Policy, the South Island is a regional economy of national significance that is currently underserved by international air services – especially to and from Asia. Asian visitors have a clear preference for visiting the South Island, but there is not enough service capacity to get them to the South Island efficiently.

32 The Airlines are prevented from including Feeder Routes in the Code Share Agreement because of the onwards code share restrictions contained in the New Zealand/China ASA. This aspect of the ASA is a considerable barrier to access to the South Island for Chinese and other Asian tourists. Direct evidence of this is provided by the structure of the NAAA and the exclusion of Feeder Routes from the Code Share Agreement.

33 This is a prime example of New Zealand's reciprocity approach harming the South Island economy. CIAL encourages the MOT to remove these onwards code share restrictions, unilaterally if necessary, when the New Zealand/China ASA is revisited in 2014.

34 If New Zealand does unilaterally remove the onwards code share restrictions, then CIAL strongly encourages Air NZ to include domestic New Zealand Feeder Routes in the Code Share Agreement.