

## AIR NEW ZEALAND - CATHAY PACIFIC ALLIANCE

<b>Reason for this briefing</b>	Air New Zealand and Cathay Pacific have applied for authorisation under section 88 of the Civil Aviation Act 1990 of alliance and code-share agreements. This briefing and the attached report set out our analysis of the application.
<b>Action required</b>	Advise whether you agree with our recommendation.
<b>Deadline</b>	As soon as possible
<b>Reason for Deadline</b>	Air New Zealand has requested that you consider our analysis as soon as possible [REDACTED]

### Contact for telephone discussion (if required)

Name	Position	Telephone		First Contact
		Direct Line	After Hours	
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	✓
[REDACTED]	[REDACTED]	[REDACTED]		

### MINISTER'S COMMENTS:

<b>Date:</b>	18 October 2012	<b>Briefing Number:</b>	OC01077
<b>Attention:</b>	Hon Gerry Brownlee (Minister of Transport)	<b>Security level:</b>	In-Confidence

### Minister of Transport's office actions

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- Withdrawn*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

## Purpose of report

1. This report outlines our advice regarding an application by Air New Zealand and Cathay Pacific seeking authorisation under the Civil Aviation Act 1990 of proposed alliance and code-share arrangements.

## Background

2. Air New Zealand and Cathay Pacific have applied for authorisation under Part 9 of the Civil Aviation Act 1990 of an integrated alliance. If approved, the alliance would enable them to cooperate on pricing and scheduling on their respective services between Auckland and Hong Kong. The alliance agreement is supported by a codeshare agreement, which would also enable Cathay Pacific to place its code on Air New Zealand's domestic services, and a Special Prorate Agreement, under which Cathay Pacific would sell seats on its connecting services to Air New Zealand at a preferential rate. The alliance does not include cooperation on freight.
3. You are the responsible authority for authorising the alliance. Regulatory approval is not required from the government of Hong Kong.
4. We have conducted a detailed assessment of the application, and our analysis is set out in this briefing and in the attached report.

## Current services

5. Air New Zealand and Cathay Pacific are currently the only airlines offering direct services between New Zealand and Hong Kong – with Air New Zealand operating a daily service (with a connecting service through to London) and Cathay Pacific operating between 7 and 10 services per week depending on demand. Between them, the two airlines carry roughly 210,000 passengers per year in each direction, with the majority (82 percent) using Hong Kong as an intermediate point en-route to another destination, such as mainland China, other points in Asia, or Europe.
6. Both airlines have found the Auckland-Hong Kong route challenging in recent years. We believe that this is in large part due to the significant decline in visitor arrivals from Europe (particularly the United Kingdom), as well as increasing fuel prices and challenging economic conditions generally. The applicants claim that China Southern's entry into the Auckland-Guangzhou market (Guangzhou is 160km from Hong Kong) has also contributed to the decline in profitability on the Auckland-Hong Kong route, but our analysis does not support this claim.
7. [REDACTED] Forty-six percent of the passengers Air New Zealand carries to Hong Kong travel through to London.

## Star Alliance

8. [REDACTED]
9. [REDACTED]

10.

[REDACTED]

11.

[REDACTED]

12.

[REDACTED]

13.

[REDACTED]  
-London route.

## Summary of analysis

### *Statutory criteria*

14. The airlines have sought authorisation of the proposal under s.88 of the Civil Aviation Act. The effect of authorisation under the Civil Aviation Act is exemption from the Commerce Act 1986.
15. The Civil Aviation Act sets out certain prohibitions – circumstances under which you may not authorise arrangements. The proposal does not fall foul of any of the prohibitions in s.88 (3) or (4) of the Civil Aviation Act, and is therefore capable of being authorised. Our full analysis of this is set out in the attached report.
16. In light of this, approval of the alliance is at your discretion, to be exercised in the public interest. The public interest involves weighing up the balance between the benefits from the alliance and any potential detriments.

### *Counterfactual*

17. If the alliance is not approved (the 'counterfactual'), it is likely that either or both of Air New Zealand and Cathay Pacific would reduce services. The airlines gave us confidential versions of their counterfactuals without reference to each other. We believe the most likely outcome without the alliance is Air New Zealand withdrawing from the Auckland-Hong Kong route altogether and Cathay Pacific maintaining a daily service.

### *Potential benefits*

18. A key benefit of the alliance, compared to the counterfactual, is that the airlines would continue to compete in the freight market. In 2011, New Zealand exported around \$815 million worth of products to Hong Kong, 35 percent of which was transported by air.
19. The alliance would offer opportunities for Air New Zealand and Cathay Pacific to draw into each others' networks in a way that could sustain a higher level of capacity than under the counterfactual.

20. The alliance would also allow Air New Zealand to maintain a presence in a hub point in Asia in a way that [REDACTED] Channelling passengers onto Air New Zealand's services from Cathay Pacific's extensive network will improve the connectivity options offered from a New Zealand base.
21. Some consumers would benefit as a result of reciprocal frequent flyer benefits and joint lounge access. As detailed in the attached report, we assess these benefits as modest.

#### *Potential detriments*

22. The alliance will remove direct competition for passengers travelling between Auckland and Hong Kong. In total, 80 percent of these passengers use direct services – the remaining passengers travel on indirect services, such as those via Australia and Singapore. This rate varies throughout the country; for example more than 50 percent of Christchurch based passengers travelling to Hong Kong use indirect services.
23. The reduction in competition will clearly give the applicants incentives to increase prices and/or reduce capacity. However, the impact of this will be limited to a relatively small group of consumers. Most passengers on the Auckland-Hong Kong route are travelling beyond Hong Kong to other destinations. There are a range of options for passengers travelling to these points and we do not consider that a reduction of competition in these markets is a concern.
24. The impact on the remaining passengers would vary; passengers based outside of Auckland require an intermediate stop regardless of whether they travel via Auckland or via a third country (such as Australia or Singapore), so the impact of reduced competition on the Auckland-Hong Kong route is less severe. Likewise, leisure passengers will be less affected as they are generally more price-sensitive and therefore more likely to accept indirect routings or alternative destinations. The passengers that would suffer the greatest potential detriment from a loss of competition on the Auckland-Hong Kong route are Auckland based business passengers, with Hong Kong as their main destination (1,960 passengers in the year ended August 2012).
25. Another concern is the impact that the alliance would have on prospects for market entry. In our view, it is relatively unlikely that another carrier would enter the Auckland-Hong Kong route, with or without the alliance. However, the airline industry is notoriously dynamic, and it is difficult to anticipate what the market dynamics would look like in the future. We believe that the alliance would significantly reduce the prospects of market entry by another carrier, as an Air New Zealand/Cathay Pacific alliance would have a significant competitive advantage as the result of having a home carrier (and the resultant economies of scale) on both ends of the route.

#### **Conclusion**

26. Based on current market conditions, particularly with respect to the dramatic decline in visitor arrivals from Europe (and especially the United Kingdom), we agree that the Auckland-Hong Kong route cannot reasonably be expected to sustain daily services by two independent carriers. Without the alliance, it is almost inevitable that one of the two carriers will exit the route (most likely Air New Zealand).
27. Compared to the status quo the alliance will result in reduced competition on the Auckland-Hong Kong route. With this there is some risk of increased fares and/or reduced capacity for

travel between Auckland and Hong Kong. As well as reducing current competition, the alliance may reduce the prospects of future competition.

28. However, the potential detriments are confined to a relatively small group of consumers, and the alliance appears to offer some consumer benefits compared to the counterfactual. Notably, the alliance would ensure that competition is maintained in the freight market (as freight is excluded from the alliance).
29. We also believe there is some national interest benefit in retaining an Air New Zealand presence in a key Asian market. This would provide Air New Zealand with a foothold in the region from which new routes could be developed in the future. There is some risk that a further retraction from Asia could have long-term implications for the viability of Air New Zealand's long-haul network.
30. Our recommendation is that you authorise the alliance for a period of three years. This is likely to lead to the best possible outcome for consumers in the short-term, and provide an incentive for Air New Zealand and Cathay Pacific to demonstrate that the alliance is delivering the stated benefits, and that it remains of benefit to the public given changing market circumstances.
31. Under the Civil Aviation Act, you are unable to impose conditions such as restrictions on the term of the Agreement. However, following consultation with staff in your office, we raised the issue of a three year term limit with Air New Zealand. Following this discussion, Air New Zealand and Cathay Pacific submitted an amendment to the agreement stating that they will cease to give effect to the alliance after three years unless it is re-authorised.

**Recommendation**

32. The recommendation is that you:

- (a) **authorise**, pursuant to section 88(2) of the Civil Aviation Act 1990: Yes/No
- (i) all of the provisions of the North Asia Alliance Agreement, made on 30 April 2012 and the First Amendment to the North Asian Alliance Agreement dated 10 September 2012; and
  - (ii) all of the provisions of the Code Share Agreement made on 18 May 2012 and the First Amendment to the Code Share Agreement dated 10 September 2012.

[REDACTED]

[REDACTED]

**MINISTER'S SIGNATURE:**

**DATE:**

# Analysis of Air New Zealand/Cathay Pacific application for authorisation of a North Asia Alliance Agreement and Code-share Agreement

## Contents

1. Outline of the proposal .....	2
2. Jurisdictional Issues.....	2
3. Framework .....	5
4. Background to airline alliances and cooperative arrangements .....	6
5. Market definition.....	8
6. Commercial rationale for the proposed alliance .....	10
7. Market Impact .....	14
- Passenger markets.....	14
- Freight .....	18
- Potential for Market Entry .....	20
8. Potential benefits.....	22
- Consumer benefits.....	22
- National benefits .....	26
- Consumer Protection .....	28
9. Counterfactual .....	28
10. Submissions .....	29
Annex A: Statutory Criteria Analysis .....	31
Annex B: Assessment of how sections relate to tariffs and capacity .....	36
Annex C – Air New Zealand Code-share and Alliance Arrangements authorised under part 9 of the Civil Aviation Act as at September 2012 .....	43
Annex D – List of States which have been granted rights by the New Zealand government to operate to New Zealand via Hong Kong.....	44

## 1. Outline of the proposal

1. Air New Zealand and Cathay Pacific have applied for authorisation pursuant to Part 9 of the Civil Aviation Act 1990 for a North Asia Alliance Agreement (the Alliance) and related Code-share Agreement. The agreements provide for:
  - a broad scheduling, pricing and capacity coordination arrangement covering:
    - all New Zealand – Hong Kong sectors operated by either airline (the Alliance Routes); and
    - feeder routes being the domestic New Zealand sector of an international route comprising an Alliance Route plus a domestic New Zealand sector connecting to an Alliance Route as part of an international itinerary
  - a free-sell code-share on the Alliance Routes
  - revenue allocation on the Alliance Routes
2. The Alliance will be supported by additional “Implementing Agreements” as follows
  - a Code-share Agreement
  - a Special Prorate Agreement (SPA) providing both new and more favourable rates on connecting flights to the Parties’ respective “beyond” destinations
  - a premium Customer and Lounge Access Agreement and
  - a Frequent Flyer Program (FFP) Agreement
3. The Parties will establish and maintain a management system to implement and oversee the Agreements including:
  - the Joint Alliance Committee whose members are senior managers of the respective airlines which will be responsible for reviewing all plans, overseeing Alliance business planning and strategy implementation
  - the Commercial Board which will be responsible for the implementation and operation of the Alliance, including sales and marketing, pricing cooperation, revenue management, cost savings and network and capacity planning; and
  - the Service Board which will be responsible for the service and performance standards of the Alliance.

## 2. Jurisdictional Issues

4. The application for authorisation of the Agreements has been made pursuant to Part 9 of the Civil Aviation Act. Part 9 sets out an alternative regime to the Commerce Act 1986 for international air carriage competition.
5. Specifically, sections 88(2) – (5) of the Civil Aviation Act provide that:
  - (2) *The Minister 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, the application of tariffs, or the fixing of capacity, or any combination thereof.*

- (3) *In considering whether to grant authorisation under subsection (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.*
- (4) *Subject to subsection (5) of this section, authorisation shall not be given under this section to any provision of any contract, arrangement, or understanding that-*
  - (a) *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*
  - (b) *Has the purpose or effect of breaching the terms of a commission regime issued under section 89 of this Act; or*
  - (c) *Unjustifiably discriminates between consumers of international air services in the access they have to competitive tariffs; or*
  - (d) *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*
  - (e) *Has the purpose or effect of preventing any party from seeking approval, in terms of section 90 of this Act, for the purpose of selling international carriage by air at any other tariff so approved; or*
  - (f) *Prevents any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding.*
- (5) *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.*

#### *Tariffs and Capacity*

6. The Act does not provide that agreements may be authorised in their entirety, but rather that any or all provisions of an agreement may be authorised so far as the provisions relate, whether directly or indirectly, to the fixing of tariffs, the application of tariffs, or the fixing of capacity, or any combination thereof.
7. In the course of consultation we undertook with targeted stakeholders on the proposal, one submitter put forward the view that the proposed arrangements include provisions which do not relate to the fixing of tariffs and/or capacity.

8. Section 88, in using the terms ‘related’ and ‘directly or indirectly’ is broad. The language was changed from the Bill as introduced which stated “so far as the provisions provide for the fixing of tariffs or capacity or both”.
9. In considering whether each of the provisions of the Agreements fall within the scope of the Act we have adopted a number of broad principles:
  - a. A schedule (i.e. a statement of what aircraft type will be operated on what route, with what frequency and at what time) relates directly to the fixing of capacity (in fact a schedule could be said to be the fixing of capacity).
  - b. A code-share arrangement whereby parties sell seats on each other’s services also relates to the fixing of capacity. Matters necessary for the smooth operation of a code-share agreement thus indirectly relate to the fixing of capacity.
  - c. ‘Tariffs’ means not just the fare paid but encompasses the conditions and benefits that go with that tariff – including on-board service, baggage allowances, access to lounges, and frequent flyer schemes.
  - d. ‘Boilerplate’ contractual provisions as part of an agreement that relates to the fixing or application of tariffs or the fixing of capacity, indirectly relate to the subject matter of the agreement.
  - e. Revenue sharing arrangements relate (directly or indirectly) to a combination of the fixing of tariffs and the fixing of capacity. Revenue sharing arrangements are also one of the mechanisms through which the applicants will incentivise themselves with regard to ‘metal neutrality’<sup>1</sup>.
10. We have concluded that all of the operationally material provisions of the Alliance Agreement and Code-share Agreement relate directly or indirectly to the fixing or application of tariffs or the fixing of capacity. A section by section analysis of the Agreements in terms of how they relate to the fixing or application of tariffs or the fixing of capacity is attached as Annex B to this report.

#### *International carriage by air*

11. Part 9 of the Act relates to international carriage by air. It does not extend to domestic services. In particular, section 88 provides that the Minister may authorise provisions “in respect of international carriage by air”.
12. The Alliance includes domestic feeder services and one submitter has questioned whether the feeder services are thus covered by the Act. This matter was also addressed in our consideration of the Air New Zealand – Virgin group alliance.
13. Section 88(1)(a) defines international carriage by air as “the carriage by air of persons, baggage, or cargo between New Zealand and any place outside New Zealand”.

---

<sup>1</sup> ‘Metal neutrality’ means a state of events in which each Party will be incentivized to treat all flights operated by the other Party as if they were flights on their own network.

14. In the context of the current Agreements the question is, for example, whether a ticketed Hong Kong-Auckland-Dunedin journey is regarded as international carriage by air on the route Hong Kong-Dunedin or as international carriage on the route Hong Kong-Auckland followed by a domestic journey on the route Auckland-Dunedin.
15. Consideration of practice and precedent in international air transport supports the conclusion that a domestic connecting sector on an international journey does form part of international carriage by air.
16. The Montreal Convention and the Warsaw Convention, which are both incorporated by reference into the Civil Aviation Act, both define international carriage by noting:

*“Carriage ...does not lose its international character merely because one contract or a series of contracts is to be performed entirely within the territory of the same State.”*

*Discretion*

17. [REDACTED]
18. [REDACTED]

### 3. Framework

19. The Civil Aviation Act does not set out any particular framework for assessing whether authorisation is appropriate in the public interest. Our analysis is broadly consistent with our approach to previous applications, and consists of:
  - a. an assessment of the proposal against the specific criteria in sections 88 (2) – (5) of the Civil Aviation Act 1990
  - b. consideration of where this proposal sits alongside other code-share and alliance agreements in the New Zealand market
  - c. consideration of the benefits claimed by the applicants
  - d. consideration of the nature and scale of any benefits to consumers or New Zealand as a whole, such as improved connectivity or an enhanced product/service offering
  - e. consideration of the nature, scale and likelihood of any possible detriments to consumers, such as reduced services or increased fares

f. An overall conclusion drawing together the factors above.

20. Revenue streams accruing to Air New Zealand rather than a foreign entity are considered benefits to New Zealand, but the government's ownership in Air New Zealand has not been a consideration.

#### **4. Background to airline alliances and cooperative arrangements**

21. International aviation is a highly regulated industry, governed by thousands of bilateral (and in some cases, multilateral) air services agreements, which set out (among other things) the nature of the air services that are permitted between any two countries, as well as the ownership criteria for airlines of those countries. A consequence of these agreements is that consolidation through mergers is relatively rare in the aviation industry compared to other global industries.

22. In response to these restrictions and with rising concern from competition authorities in the United States, Europe and Australia about the cartel-like nature of tariff setting and interlining<sup>2</sup> through the International Air Transport Association, in the late 1990s many of the major network airlines started entering into three global airline alliances: Star; Oneworld; and Skyteam. Members of these global alliances cooperate to extend the networks of their individual member airlines by offering interlining, frequent flier points and reciprocal lounge access. The airlines also have a tendency to codeshare on a bilateral basis with fellow global alliance members, buying seats on one another's operations.

23. The level of cooperation between and among members of the three global alliances varies greatly. As noted by the European Commission and the United States Department of Transportation, "the trend towards joining a global alliance may not necessarily represent consolidation or reduced competition in the aviation industry"<sup>3</sup>.

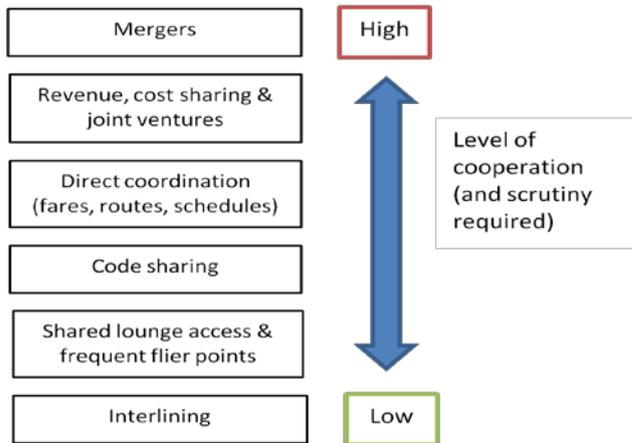
24. A separate trend has been the development of integrated airline alliances. These arrangements involve a greater level of cooperation than through the three global alliances. Cooperation may include joint setting of prices and capacity, revenue sharing, and alignment of products and services. In many ways, these arrangements resemble mergers – except that there is no joint ownership, and coordination is generally confined to specified routes. The cooperation sought by the applicants in the current proposal (on the Alliance routes) is at the higher end of the cooperation spectrum, as shown in the diagram below.

---

<sup>2</sup> 'Interlining' is a voluntary commercial agreement between individual airlines to handle passengers travelling on itineraries that require multiple airlines.

<sup>3</sup> "Transatlantic airline alliances: competitive issues and regulatory approaches" report by the European Commission and United States Department of Transportation, 2010.

**Figure 1: Spectrum of airline cooperation**



25. Examples of integrated alliances which have been approved by competition authorities include three separate Trans-Atlantic alliances (integrated joint ventures) between airlines within each of the three global alliances, and in the New Zealand context, an integrated alliance between Air New Zealand and Virgin Australia (formerly Virgin Blue) on trans-Tasman routes. The latter was approved by the New Zealand Minister of Transport and the Australian Competition and Consumer Commission in 2010.
26. A list of Air New Zealand’s code-share arrangements or alliances which have been authorised under the Civil Aviation Act is attached as Annex C. With the notable exception of the arrangements with the Virgin Australia group, most of them are with Star Alliance partners or with Pacific Island airlines.
27. The current proposal is unique among other integrated alliances globally, in that it involves competition on a single international route (Auckland-Hong Kong) between members of different global alliances (Air New Zealand is a member of Star Alliance, while Cathay Pacific is a member of Oneworld). We are not aware of any alliance with similar characteristics being approved by a regulatory authority in any other jurisdiction. There are examples of other jurisdictions approving broader alliances with the specific exclusion of routes in which only two carriers operate<sup>4</sup>.
28. In recent years due to growth in Gulf state carriers and low cost carriers which have traditionally not joined the global alliances, these relationships have become more fluid. The recently announced proposal by Qantas and Emirates to form a “Master Coordination Agreement” is a prime example of this. As part of this proposal, Qantas will be ending its long standing relationships with its Oneworld partners British Airways and Cathay Pacific. Qatar Airways has subsequently announced it will be joining Oneworld.

<sup>4</sup> In its consideration of a joint venture between United Airlines and Lufthansa in 1996, the United States Department of Transportation imposed ‘carve outs’ from antitrust immunity for the Frankfurt-Chicago and Frankfurt-Washington routes – the only routes then served by both airlines on a nonstop basis.

## 5. Market definition

29. Air New Zealand and Cathay Pacific are the only two carriers operating direct services between Auckland and Hong Kong. However, the applicants have argued that the relevant market on which any competitive effects should be assessed is the market for travel between New Zealand and the Pearl River Delta region.
30. The Pearl River Delta region includes the Special Administrative Regions of Hong Kong and Macau, as well as parts of the Guangdong province in China (including the major cities of Shenzhen and Guangzhou). The Pearl River Delta is one of the most densely populated regions in the world, with a population of between 60 and 120 million, depending on its definition. The major cities in the Pearl River Delta are interconnected through a network of highways and high speed railways. Passengers can travel between Guangzhou and Hong Kong by rail in less than two hours, and the distance between the major airports in Hong Kong and Guangzhou is approximately 160km.

**Figure 2: Map of the Pearl River Delta region**



31. Services to/from cities in the Pearl River Delta region are currently offered by Air New Zealand and Cathay Pacific on the Auckland-Hong Kong route, and by China Southern on the Auckland-Guangzhou route.
32. The applicants argue that the close proximity and ease of travel between Guangzhou and Hong Kong means that China Southern's direct service between Guangzhou and Auckland effectively provides direct competition to their services between Auckland and Hong Kong. They argue that this would limit the ability of an Air New Zealand/Cathay Pacific alliance to reduce capacity and/or increase fares on the Auckland-Hong Kong route.
33. In most cases, there would likely be some degree of substitution between airports located 160km apart. For instance, in the New Zealand-Southern Queensland market, price sensitive passengers may consider Gold Coast (Coolangatta) airport to be a viable substitute for

Brisbane airport (108km away). However, our analysis indicates that this is not the case in the Hong Kong market.

34. Travelling between Hong Kong and China requires a border crossing. While crossing the border is straight-forward, New Zealand residents require a visa and Hong Kong residents require a 'home return permit'. The cost of obtaining a visa (\$210 for a double entry visa for a New Zealand resident) and the hassle of filing the necessary paperwork appear to be deterring passengers from travelling via Guangzhou, despite the significantly lower fares currently offered by China Southern.

35. The market shares for each of Air New Zealand, Cathay Pacific and China Southern for each of the various passenger markets are shown below:

**Table 1: Passenger share of markets in the Pearl River Delta region by carrier**

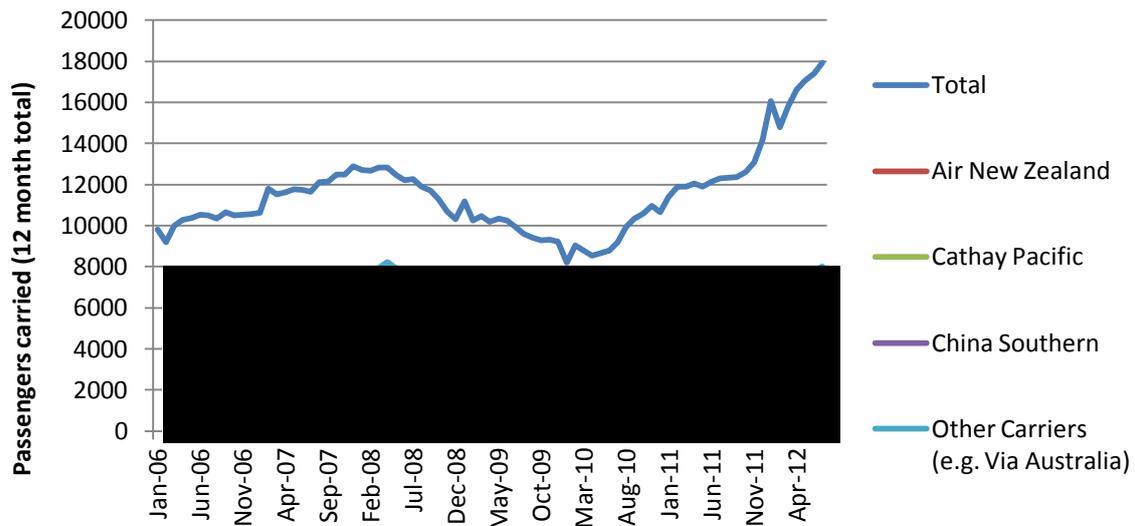
	Air NZ	Cathay Pacific	China Southern	Other carriers
Guangdong residents travelling to New Zealand	■	■	■	■
Hong Kong residents travelling to New Zealand	■	■	■	■
Macau residents travelling to New Zealand	■	■	■	■
New Zealand residents travelling to China <sup>5</sup>	■	■	■	■
New Zealand residents travelling to Hong Kong	■	■	■	■
New Zealand residents travelling to Macau	■	■	■	■

36. It is clear from the data that all three airlines are competing for passengers travelling between New Zealand and Guangdong province. However, the competition provided by China Southern for passengers travelling between New Zealand and either Hong Kong or Macau is almost negligible.

37. As shown in the graph below, the impact of China Southern on the number of Guangdong residents travelling on Air New Zealand and Cathay Pacific has also been minimal. In fact, in the last 12 months, Air New Zealand carried more Guangdong residents to New Zealand (either via Hong Kong, Shanghai, or Beijing) than it did in the 12 months before China Southern started its Guangzhou-Auckland service. The impact of China Southern has been primarily to grow the market, rather than attracting passengers who would have otherwise travelled on Air New Zealand or Cathay Pacific.

<sup>5</sup> Data does not provide an indication of which Chinese provinces New Zealand residents are visiting. The figure for Air New Zealand will therefore include passengers travelling on its service to Shanghai and its recently terminated service to Beijing.

**Figure 3: Arrivals from Guangdong province by carrier**



38. We therefore consider that the "market definition" for assessing the competitive effects of the alliance is the New Zealand-Hong Kong/Macau market. This market features direct competition between Air New Zealand and Cathay Pacific, with further competition provided by indirect services (particularly via Australia and Singapore).

39. As the applicants have noted, only 18% of passengers onboard the non-stop Auckland-Hong Kong flights are actually travelling between the two markets. The vast majority of passengers are travelling onwards to other points in Asia or Europe. While routes beyond Hong Kong are not included in the alliance, the impact that the alliance will have on these markets is a relevant consideration in our analysis. We have therefore considered the impact of the alliance on the New Zealand – China, New Zealand – Asia (other than China and Hong Kong) and New Zealand – Europe markets in addition to the New Zealand-Hong Kong/Macau market (discussed further in the Market Impacts section of this report).

## 6. Commercial rationale for the proposed alliance

40. It is evident that there has been a significant decline in the profitability of the Auckland-Hong Kong route over the past 2-3 years. This is supported by information provided by both applicants.

41. It is likely that the decline in profitability has been driven by a combination of several different factors. The applicants have provided a range of possible explanations, some of which are discussed in this section.

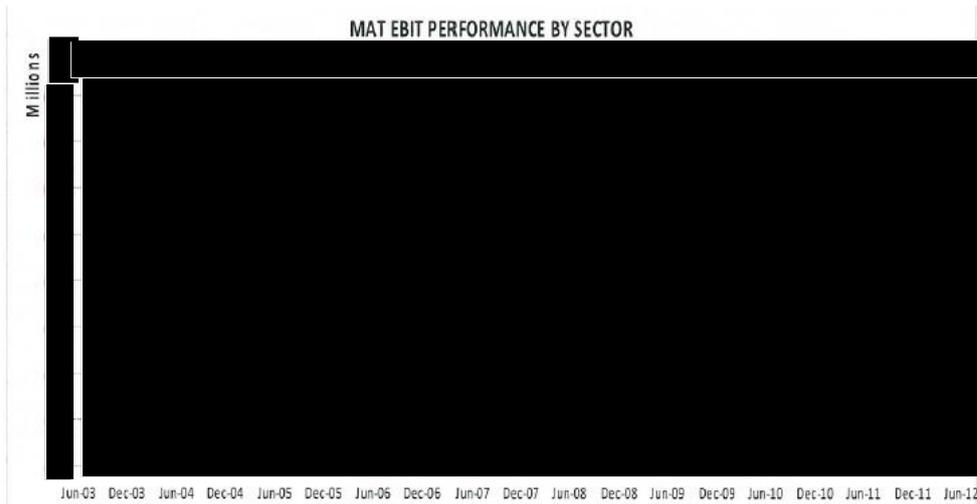
42. In presenting its counterfactual, Cathay notes that it started services to New Zealand in 1983. Cathay asserts that the route

[Redacted] In the context of Cathay's network, Hong Kong-Auckland is a "long and thin" route. [Redacted]

[REDACTED]

43. [REDACTED] Approximately 46% of Air New Zealand passengers on the Auckland – Hong Kong route connect through to London.

**Figure 4: Air New Zealand earnings before interest and taxation (Moving Annual Total)** [REDACTED]

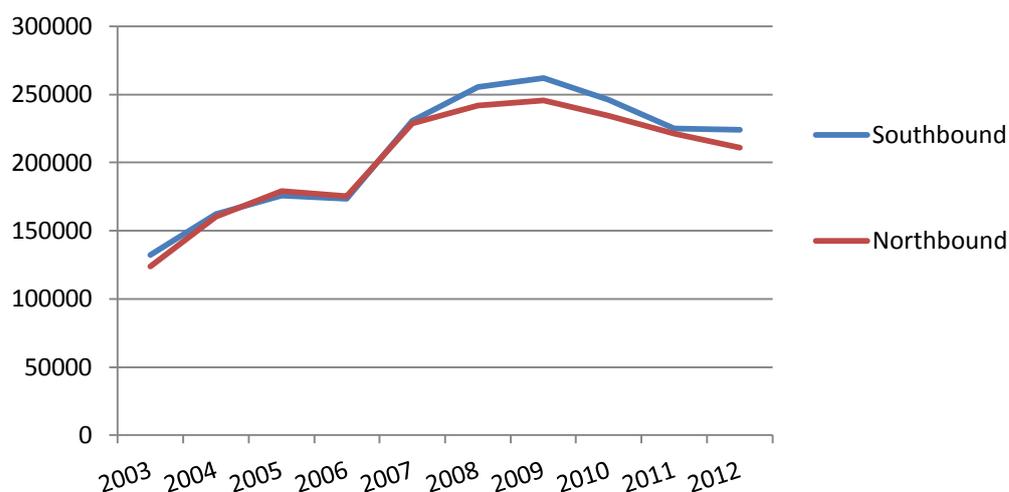


44. In order to maintain existing capacity on the Auckland-Hong Kong route, Air New Zealand would need to replace these passengers with passengers travelling to Hong Kong, or connecting to services provided by other airlines. This would be difficult to achieve, particularly without a strong commercial arrangement with a Hong Kong based carrier. Past performance of the Auckland – Hong Kong route has been poor without the London connection.

*Reduced demand*

45. As shown in the graph below, total passengers on services between Hong Kong and Auckland (including Air New Zealand services through to London) have declined in recent years.

**Figure 5 - Total passengers on Hong Kong-Auckland services (Year Ended July)**



46. Demand from Europe has been in decline for a number of years. In total, visitor arrivals from Europe have fallen from 549,015 in the year ended July 2006 to 470,915 in the year ended July 2012. As shown in Table 2 below, the impact has been most severe on the United Kingdom market. This is likely to be partly a consequence of repeated increases in the United Kingdom's Air Passenger Duty, which has significantly increased the cost of travelling to/from the United Kingdom relative to other European countries. The Air Passenger Duty for passengers travelling to New Zealand from airports in the United Kingdom is among the highest in the world, at £92 for an economy class passenger<sup>6</sup> and £184 for passengers travelling in other classes.

**Table 2: Visitor arrivals from European markets, 2007-2012**

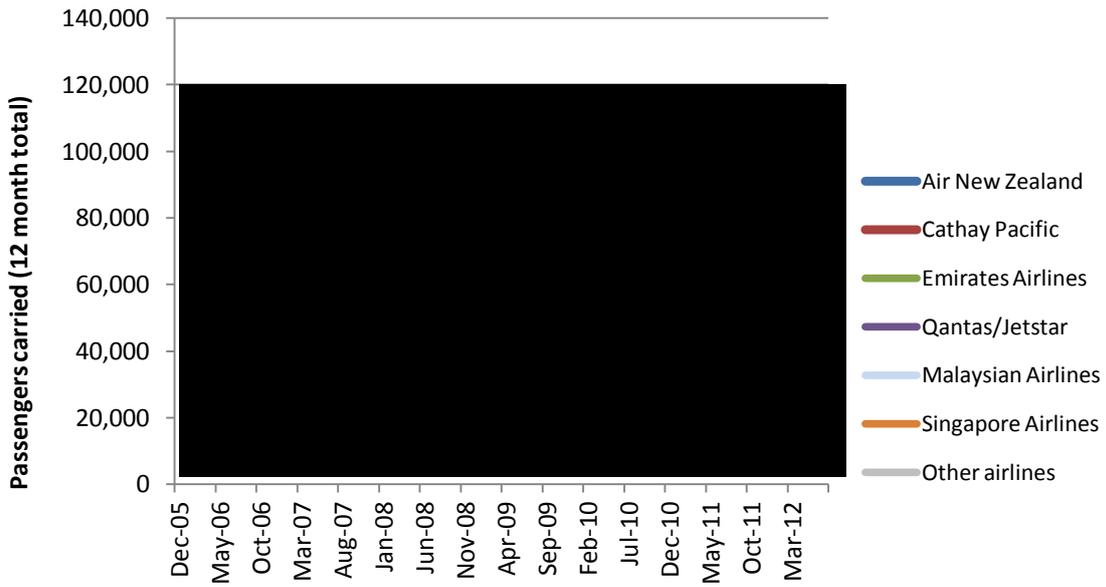
YE July:	UK	Ireland	Germany	France <sup>7</sup>	Netherlands	Other	TOTAL
<b>2007</b>	322,564	21,754	61,854	20,270	28,057	94,516	549,015
<b>2008</b>	309,515	22,915	63,327	20,842	26,110	98,215	540,924
<b>2009</b>	279,477	20,426	65,761	22,787	25,121	97,056	510,628
<b>2010</b>	262,070	15,931	67,498	25,927	24,298	99,195	494,919
<b>2011</b>	233,444	13,507	67,455	25,933	24,016	100,237	464,592
<b>2012</b>	226,883	18,024	65,205	38,704	22,811	99,288	470,915
<b>% change</b>	-29.7%	-17.1%	+5.4%	+90.9%	-18.7%	+5.0%	-14.2%

47. Reduced demand from the United Kingdom has not impacted on all carriers equally, although most carriers serving the market have been affected to some extent. [REDACTED] In our view, the decline in demand from Europe is the most significant factor impacting on the viability of Air New Zealand's Auckland-Hong Kong service.

<sup>6</sup> The duty has increased from £55 in November 2009 and £85 in November 2010 to the current level.

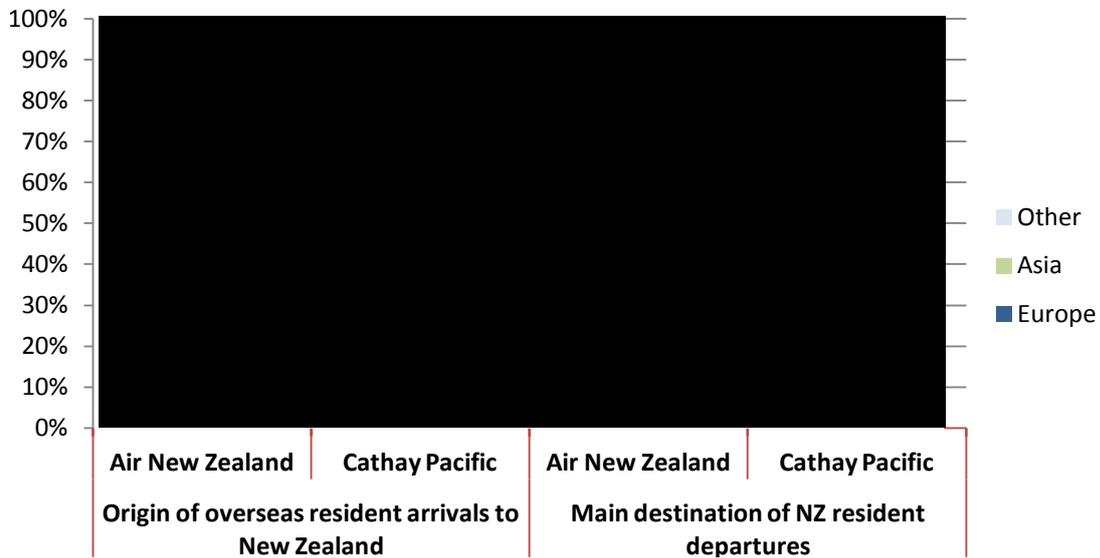
<sup>7</sup> The increase in arrivals from France in the year ended July 2012 is primarily attributable to the Rugby World Cup

**Figure 6: UK visitor arrivals by carrier**



48. The impact on Cathay Pacific has been less severe, as the majority of passengers on its Auckland-Hong Kong service originate from within Asia. As shown in the figure below, more than 60 percent of inbound passengers travelling on Air New Zealand’s Auckland-Hong Kong service originate from within Europe (the majority of these from the United Kingdom), compared to less than 30 percent for Cathay Pacific.

**Figure 7: Origin/Destination of passengers travelling on AKL-HKG services (year ended July 2012)**



*Rising fuel prices*

49. Both applicants have cited the impact of rising fuel costs on the profitability of their services. As noted by Cathay Pacific, the price of Brent crude oil has exceeded US\$100 a barrel for well over a year, and average fuel prices have never been higher. The Auckland-Hong Kong route, along with most other international routes to/from New Zealand, is a “long and thin” route, with a flight time of approximately eleven hours and relatively low passenger demand.

These routes are particularly exposed to increases in fuel prices, as fuel represents a greater portion of total operating costs on long-haul flights.

50. Rising fuel costs are likely to have had a significant impact on passenger demand, and therefore on the financial performance of the applicants Auckland-Hong Kong services.

*Competition on ‘China’ routes*

51. As mentioned earlier in this report, we acknowledge China Southern is competing with the applicants for passengers travelling between China, particularly Guangdong province, and New Zealand. However, we are not convinced that China Southern’s Auckland-Guangzhou service has had a significant impact on the Auckland-Hong Kong market.

52. There are a number of airlines (including China Southern) competing with the applicants for passengers travelling beyond Hong Kong to other destinations, particularly those which require an intermediate stop (such as Europe). However, competition in these markets is unlikely to have had a significant impact on the viability of the Auckland-Hong Kong route as it has remained relatively constant for several years.

## 7. Market Impact

### Passenger markets

53. As noted in paragraph 39, the New Zealand-Europe, New Zealand-China, and New Zealand-Asia (other than China and Hong Kong) markets are all relevant considerations in our analysis. These markets account for approximately 84% of passengers on the Auckland-Hong Kong route. As shown in table 3, all three of these markets are highly competitive.

**Table 3: Passenger share of NZ-Europe, NZ-China and NZ-Other Asia markets by carrier**

	NZ-Europe		NZ-China		NZ-Other Asia	
Air New Zealand						
Emirates Airlines						
Qantas						
Singapore Airlines						
Cathay Pacific						
Korean Air						
Malaysian Airlines						
Jetstar						
Pacific Blue Airlines						
Thai Airways						
LAN Chile						
Air Pacific						
Air Asia X						
Jetstar Asia						
China Southern						
China Airlines						
Other Airlines						
<b>Total</b>	636,128	100.0%	253,157	100.0%	529,820	100.0%

54. Passengers travelling to Europe have multiple one-stop and two-stop options through points in Asia, North America and the Middle East. Passengers travelling to China are able to choose from direct services to Shanghai (Air New Zealand) and Guangzhou (China Southern), as well as a range of indirect services via Australia or other points in Asia. The wider Asia market is well served from New Zealand with direct services to Bangkok, Kuala Lumpur, Tokyo, Osaka, and Seoul, and a seasonal service to Bali.
55. The extent of competition means that the applicants will have limited scope to raise fares in these markets. In addition to existing competitors, there a number of airlines in the Asia-Pacific region which have either expressed an interest in operating to New Zealand, or would be well placed to commence services if a market opportunity emerged.
56. Of more concern is the impact the alliance will have on passengers travelling between New Zealand and Hong Kong/Macau. In contrast to the other markets which have been identified, the New Zealand-Hong Kong/Macau market is relatively uncompetitive. Air New Zealand and Cathay Pacific account for █████ of the inbound market and █████ of the outbound market. Under the alliance, all competition in the direct Auckland-Hong Kong market would be removed.

**Table 4: Share of New Zealand-Hong Kong/Macau market by carrier – year ended July 2012**

	Total passengers	Air New Zealand	Cathay Pacific	Qantas	Singapore Airlines	Other Airlines
Hong Kong Residents to New Zealand	27,142	█████	█████	█████	█████	█████
New Zealand residents to Hong Kong	18,500	█████	█████	█████	█████	█████

57. Passengers have the option of travelling on indirect services, such as Qantas services via Australia. However, less than 20% of passengers travelling between Auckland and Hong Kong travel on indirect services. This indicates that there is no significant price advantage for Auckland based passengers travelling on less convenient, indirect routes.
58. It is likely that the removal of direct competition on the Auckland-Hong Kong route (either as a result of the alliance or a counterfactual scenario in which one carrier pulls off the route) would result in higher fares on the direct service and an increase in the proportion of passengers travelling on indirect alternatives. As shown in the graph below, passengers are more likely to travel on direct services when the route is competitive (such as Hong Kong, Singapore, and until recently, Malaysia<sup>8</sup>).

<sup>8</sup> Air Asia X ended its direct Kuala Lumpur-Christchurch service in April 2012.

**Figure 8: Proportion of inbound passengers travelling on direct/indirect services**



59. However, for passengers originating outside of Auckland, an intermediate stop is required no matter which route they chose to travel on. For these passengers service via Australia would appear to be similarly convenient to a direct flight from Auckland (as both options would require an intermediate stop). In fact, for passengers travelling from Christchurch it is actually marginally quicker to travel to Hong Kong via Sydney than via Auckland.

**Flight options between Auckland and Hong Kong**

Route	Airline	Duration
Auckland-Hong Kong (Direct Service)	Air New Zealand	11:31
Auckland-Hong Kong (Direct Service)	Cathay Pacific	11:40
Auckland-Sydney-Hong Kong	Qantas	14:00
Auckland-Singapore-Hong Kong	Singapore Airlines	15:30

**Flight options between Christchurch and Hong Kong**

Route	Airline	Duration
Christchurch-Sydney-Hong Kong	Air NZ/Cathay Pacific	14:50
Christchurch-Auckland Hong Kong	Air New Zealand	15:10
Christchurch-Sydney-Hong Kong	Jetstar/Qantas	15:25
Christchurch-Singapore-Hong Kong	Singapore Airlines	15:55
Christchurch-Auckland-Hong Kong	Air NZ/Cathay Pacific	16:10

60. As shown in the table below, 51% of Christchurch based passengers already travel on indirect services. Christchurch based passengers are therefore likely to be less affected by any attempt by the applicants to increase prices on the alliance route.

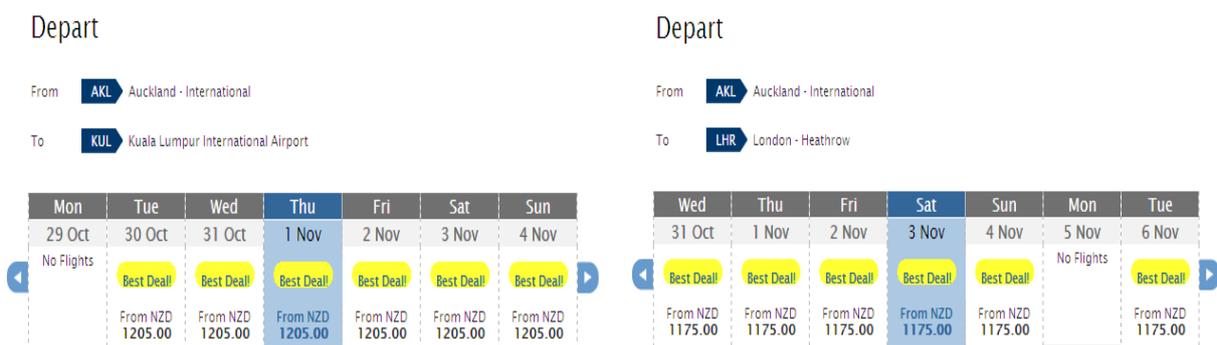
**Table 5 - proportion of passengers travelling on direct and indirect services by region**

	Direct route (AKL-HKG)		Indirect routes (e.g. via Australia/Singapore)	
	Passengers	%	Passengers	%
<b>Auckland</b>	9,780	83%	2,060	17%
<b>Wellington</b>	1,300	78%	360	22%
<b>Other North Island</b>	1,540	77%	460	23%
<b>Christchurch City</b>	500	49%	520	51%
<b>Other South Island</b>	1,020	77%	300	23%
<b>Total</b>	<b>14,140</b>	<b>79.3%</b>	<b>3,700</b>	<b>20.7%</b>

61. Business passengers, who place a greater value on time and are less likely to consider less convenient alternatives (i.e. are less price sensitive), would be most impacted if the applicants sought to increase fares under the proposed alliance. ████████ of Cathay Pacific passengers and █████ percent of Air New Zealand passengers are travelling for business purposes.

62. The applicants have argued that their incentives to raise prices would be limited by the fact that the majority of passengers on the Auckland-Hong Kong route are travelling to other destinations, in which there is adequate competition. However, there is nothing to prevent the applicants from pricing independently on the Auckland-Hong Kong sector (in other words, raising prices on tickets booked between Auckland and Hong Kong while maintaining competitive pricing on tickets with connecting flights). In aviation, fares are not always proportionate to distance – particularly on non-competitive routes. For example, the screenshots below show one-way fares on Malaysia Airlines flights in November 2012 to Kuala Lumpur and London. A one-way ticket to London (a competitive route) is cheaper than a one-way ticket to Kuala Lumpur (a non-competitive route), despite the fact that passengers must travel through Kuala Lumpur en-route to London.

**Figure 9: Sample itineraries for travel booked on Malaysia Airlines to London and Kuala Lumpur**



63. This may be an extreme example, and is likely a reflection of the intense competition in the New Zealand-London market. However, it clearly indicates that competition to markets beyond Hong Kong would not necessarily constrain fares between New Zealand and Hong Kong.

64. Air New Zealand has argued that the ability of the applicants to raise prices on the Auckland-Hong Kong route would also be limited by pricing on other routes, because many price-

sensitive leisure passengers would be willing to substitute other destinations for Hong Kong. For example, a New Zealander planning a holiday in Hong Kong may consider travelling to other parts of Asia, such as Singapore or Shanghai, if fares on those routes were significantly cheaper.

65. We agree that some leisure passengers would be driven towards other destinations if the applicants sought to increase prices on the Auckland-Hong Kong route. The extent to which this would constrain the applicants is dependent on whether the revenue lost from price-sensitive passengers would exceed the revenue gained by increasing the yield from passengers who continue to travel on the route.

66. In the year ended August 2012, 50 percent of Hong Kong residents and 31 percent of New Zealand residents travelling on the Auckland-Hong Kong route were travelling for holiday purposes (see table 6).

**Table 6 - purpose of travel of passengers on Auckland-Hong Kong route (year ended August 2012)**

Purpose of travel	Hong Kong resident arrivals	NZ resident departures
Business	7.7%	16.6%
Conventions/Conferences	1.0%	2.6%
Education	4.4%	1.5%
Holiday/Vacation	50.3%	30.6%
Visiting Friends/Relatives	33.3%	46.1%
Other	3.3%	2.6%

## Freight

67. The North Asia Alliance Agreement covers passenger services only. It does not directly cover freight (cargo revenue is explicitly excluded from the definition of Alliance revenues). Nevertheless, because freight on the New Zealand – Hong Kong route is largely carried in the bellyhold of passenger services, changes in the passenger market will have an impact in freight markets.

68. Under the proposed Alliance, Air New Zealand and Cathay Pacific will continue to market and price freight capacity separately, thus maintaining competition in this sub-market.

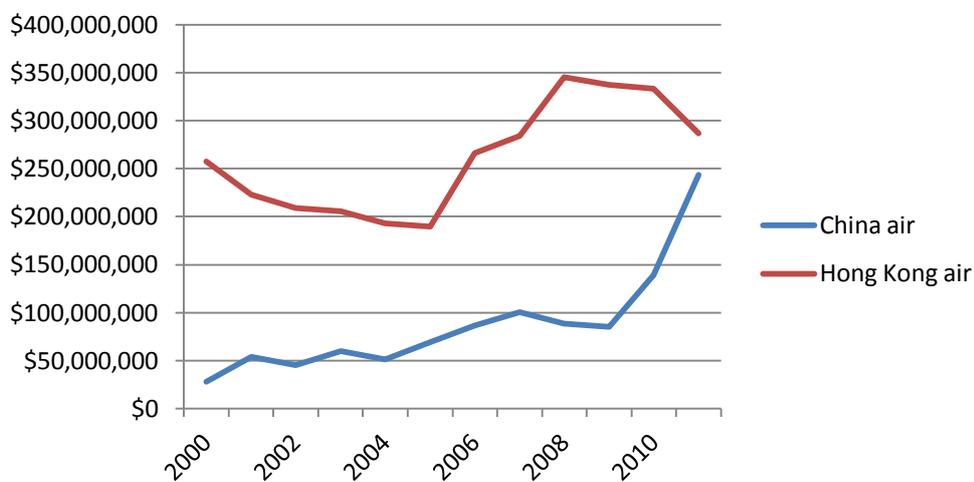
69. On the other hand, a reduction in services offered, either under the Alliance or in the counterfactual, would have the following effects:

- Potential lack of capacity for perishable shipments (fish, lobsters) requiring time sensitive point to point transport
- Potential increase in freight rates
- Long transit times through Australia
- New Zealand producers competing with Australian producers for capacity from Australia to Hong Kong.

70. Air New Zealand and Cathay Pacific both operate wide-bodied aircraft on the New Zealand – Hong Kong route (Air New Zealand generally operates Boeing B777 aircraft on the route while Cathay Pacific uses Airbus A340 aircraft). These aircraft can carry significantly more freight than the A320 and B737 aircraft operated by carriers on short-haul trans-Tasman services, which do not have sufficient range to operate non-stop between Auckland and Hong Kong.

71. As shown in the graph below, the value of air freight exports from New Zealand to Hong Kong has dropped somewhat in recent years. This may be in part a consequence of the Free Trade Agreement with China meaning that some products which previously entered China through Hong Kong are now going direct.

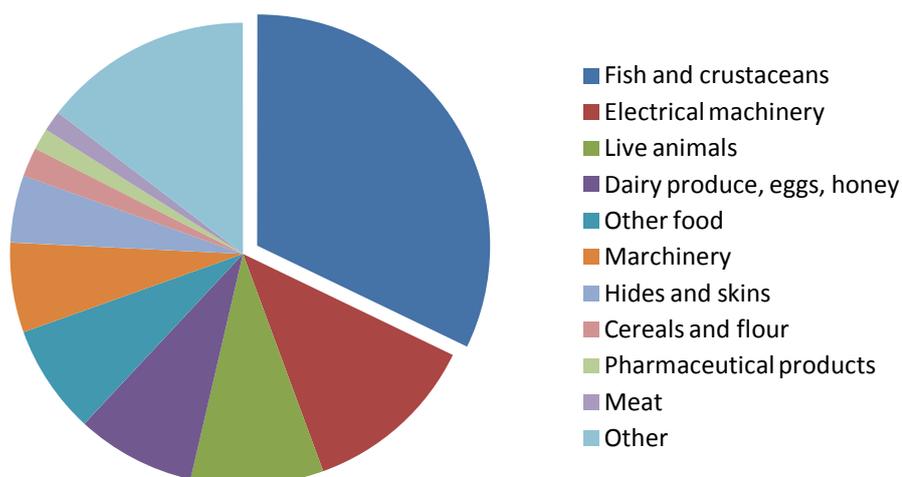
**Figure 10 - New Zealand exports by air to Hong Kong and China**



72. Nevertheless airfreight remains important in New Zealand – Hong Kong trade. In 2011, New Zealand exported around \$815 million worth of products to Hong Kong. This represented 1.6 percent of New Zealand’s total exports. Of these 35 percent are air-freighted (compared to 16 percent of New Zealand exports to all countries and only 5 percent of exports to mainland China). In the same period around 40 percent of the \$157 million of imports from Hong Kong arrived by air (this compares with 20 percent of all imports).

73. In 2011, 32 percent of New Zealand's airfreight exports to Hong Kong were seafood – often a particularly time sensitive product (see figure 11).

**Figure 11 - New Zealand air freight exports to Hong Kong by commodity (2011)**



74. It is not possible to tell from the data how much of the product leaving Auckland is going on the non-stop services provided by Air New Zealand and Cathay Pacific, and how much is going via third countries such as Australia. However, in 2011, 30 percent of airfreight exports to Hong Kong left through Christchurch (meaning that portion at least was carried on indirect services).

### Potential for Market Entry

75. The applicants have argued that there are several carriers which are 'poised' for potential entry into the market. This is significant, as Air New Zealand and Cathay Pacific would be less likely to increase prices if they thought it would encourage a strong competitor to enter the market. According to the applicants, poised carriers include Hong Kong Airlines, Jetstar, and Jetstar Hong Kong, as well as various 'fifth-freedom' carriers.

#### *Hong Kong Airlines*

76. Hong Kong Airlines is a Hong Kong based carrier currently operating to a number of destinations throughout Asia. It has grown rapidly since its incorporation in 2001, and currently operates a number of wide-body Airbus A330-200 aircraft which are capable of serving the New Zealand market.

77. However, Hong Kong Airlines is currently unable to expand its fleet further as a result of a restriction imposed on them by the Hong Kong Civil Aviation Department due to safety concerns<sup>9</sup>. This would constrain Hong Kong Airlines' ability to enter the New Zealand-Hong Kong market in the event that the alliance sought to increase fares and/or reduce capacity.

<sup>9</sup> <http://atwonline.com/international-aviation-regulation/news/cad-freezes-hong-kong-airlines-fleet-expansion-plans-0807>

### *Jetstar Hong Kong*

78. Jetstar Hong Kong is a planned Joint Venture between Qantas and China Eastern Airlines which intends to commence operations from Hong Kong in 2013. The airline is yet to receive regulatory approval from the Hong Kong authorities and, as noted by the applicants, there are several questions regarding its eligibility to receive a Hong Kong operating permit as it will be 100% foreign owned.
79. Jetstar Hong Kong has announced that, pending regulatory approval, its immediate focus will be on intra-Asia traffic. Its initial fleet will consist of short-haul A320 aircraft which are not capable of operating to New Zealand. It is highly unlikely that Jetstar Hong Kong will be in a position to enter the New Zealand-Hong Kong market in the short or medium term.

### *Jetstar*

80. The applicants have also suggested that Australian based, Qantas owned, Jetstar could re-organise itself into a New Zealand based subsidiary with New Zealand based investors to operate between New Zealand and Hong Kong. While such ownership structures are not unknown in aviation and Jetstar has aircraft on order that could be suited to the New Zealand – Hong Kong route, the applicants and their advisers note that this is perhaps less likely than services by Jetstar Hong Kong.

### *5<sup>th</sup> freedom carriers (third country airlines)*

81. As noted by the applicants, there are a number of third-country airlines (such as British Airways and Virgin Atlantic) that have the necessary air rights under our agreements with their home countries to operate to New Zealand with an intermediate stop in Hong Kong. We are not certain exactly how many airlines would be able to do this, as the necessary rights would also be required from the Hong Kong authorities. Despite being liberal in other areas of trade, Hong Kong has generally been quite protectionist in its air services policy.
82. New Zealand has exchanged these rights with around 30 countries (see Annex D), although many of these have restrictions on frequency.
83. No European carrier has operated scheduled services to New Zealand since 1995, due to challenging economics on services which require an intermediate stop. The likelihood of a third country airline (from Europe or elsewhere) entering the New Zealand-Hong Kong route is low.

### *Impact of the Alliance*

84. Under the Alliance, Air New Zealand and Cathay Pacific would have significant competitive advantages that would be difficult for other carriers to replicate. In particular, the alliance would have the benefit of having a home base at either end of the route. As a result of economies of scale, carriers operating from their home base tend to have lower variable costs than other carriers.
85. Prospects for competition would also be impacted by the fact that the two carriers are members of different global alliances. It is rare for two members of the same global alliance

to compete on the same route, particularly where it is a fifth freedom route<sup>10</sup> for one of them. It is therefore highly unlikely that a member of either Oneworld<sup>11</sup> or the Star Alliance<sup>12</sup> would choose to compete against an Air New Zealand/Cathay Pacific alliance on the Auckland-Hong Kong route.

86. In our view, it is likely that the Alliance could have the effect of deterring other carriers from entering the route (i.e. the Alliance could act as a barrier to market entry). This would be particularly true for full service carriers, which have less scope to compete with an alliance on price.

## 8. Potential benefits

### Consumer benefits

87. The applicants have claimed that the alliance will lead to a range of consumer benefits. These are discussed below.

#### *Increase in 'online' frequencies and time of day benefits*

88. Air New Zealand and Cathay Pacific both offer a daily service on the Auckland-Hong Kong route, with each airline operating at different times of the day.
89. Under the alliance, the parties will “make capacity available without restriction to the other Party” on the Auckland-Hong Kong route. According to the applicants, this would provide a benefit to consumers by increasing the number of flight options available throughout the day. The applicants claim that “the time of day benefit is of high value to both connecting and origin-destination passengers and would not be possible absent the proposed Alliance”.
90. This does not increase the total number of services available. Passengers already have the ability to choose between the services offered by both airlines. This benefit is primarily limited to passengers who have a reason to travel on one airline over the other (for example, passengers who are members of the frequent flyer programmes of one (but not both) airlines).
91. Improved scheduling is often seen as a key benefit from integrated airline alliances. This particularly applies on routes in which two carriers are operating ‘wingtip-to-wingtip’<sup>13</sup>, or on thin routes where neither carrier operates a daily service. However there is little scope to improve flight schedules under the proposed Alliance, as the carriers are already operating at different times of the day and on all days of the week.

---

<sup>10</sup> A route which includes an intermediate stop between its origin and destination

<sup>11</sup> Members of oneworld with the necessary air rights from the New Zealand government to operate on the Auckland-Hong Kong route include Qantas, American Airlines, Japan Airlines, and British Airways, among others.

<sup>12</sup> Members of the Star Alliance with the necessary air rights from the New Zealand government to operate on the Auckland-Hong Kong route include United Airlines, US Airways, Singapore Airlines, Lufthansa, and All Nippon Airways, among others.

<sup>13</sup> Competing airlines often cluster their flights at peak travel times to capture the most lucrative segment of the market. For example, in considering the Air New Zealand/Pacific Blue alliance we noted that there were 34 Pacific Blue flights departing within half an hour of an Air New Zealand flight on the same route.

### *Improved access to connecting flights*

92. The alliance would provide the customers of each airline with additional flight options on both sides of the route. In particular, the inclusion of New Zealand domestic sectors as code-share routes in the arrangements means that Cathay Pacific will be able to sell tickets to regional destinations in Air New Zealand's domestic network.
93. Connecting flights beyond Hong Kong on Cathay Pacific are not included in the codeshare agreement. Instead, Air New Zealand will be able to access these flights through a Special Prorate Agreement. This agreement effectively means that Cathay Pacific will sell seats on these flights to Air New Zealand at a discounted rate.
94. A wide range of destinations and frequencies are included in the Special Prorate Agreement. Air New Zealand will benefit from not only being able to sell tickets on Cathay Pacific's Auckland-Hong Kong service, but also on flights that connect with that service in Hong Kong.
95. The ability to sell tickets to a greater number of destinations is a significant benefit for the applicants. However, the benefits for consumers are less clear. Passengers already have access to connecting flights, by booking a ticket with Cathay Pacific (when travelling beyond Hong Kong) or with Air New Zealand (when travelling beyond Auckland to other points in New Zealand or Australia). The consumer benefits would be primarily limited to passengers with a loyalty towards one airline, or passengers with a connecting journey on both sides of the route (assuming that the lower prices paid by each airline on connecting flights are passed on to consumers).
96. Air New Zealand's ability to offer more comprehensive services through Hong Kong is limited in part due to the New Zealand-Hong Kong Air Services Agreement. The Agreement limits

### *Enhanced product and service offerings*

97. The applicants claim that the proposed alliance will enable them to enhance customer experience by aligning products and services to achieve a 'consistent end to end product offering'. These benefits include:
- Reciprocal lounge access on alliance routes, and for Air New Zealand customers connecting onto Cathay/Dragonair services to points in China (initially Beijing and Shanghai)
  - Premium customer handling reciprocity on alliance routes
  - The provision of reciprocal frequent flyer programme benefits on alliance routes
98. Access to airport lounges is generally reserved for a relatively small group of passengers, who are able to obtain access either by purchasing a lounge membership, acquiring lounge membership through their frequent flyer status, or by purchasing a business-class fare.

99. Air New Zealand has its own lounge at Auckland Airport, and Air New Zealand passengers have access to a shared lounge at Hong Kong airport. Cathay Pacific has its own lounge at Hong Kong airport, and its passengers are able to access the Qantas lounge at Auckland Airport. Passengers of either airline are therefore already able to access lounges on both sides of the Auckland-Hong Kong route. The benefit to consumers of shared lounge access is limited to Air New Zealand passengers travelling beyond Hong Kong on Cathay Pacific or Dragonair to either Beijing or Shanghai (who would not otherwise have access to a lounge in Hong Kong) and passengers with a premium membership status in one, but not both of the airlines' frequent flyer programmes, travelling on a service operated by the other airline.
100. According to Air New Zealand's own research, only 3 percent of international passengers regard access to airport lounges as a key consideration when purchasing an air ticket<sup>14</sup>.
101. The ability to 'earn and burn' frequent flyer benefits on the services of the other airline will have some benefit to a much wider group of consumers. Reciprocal frequent flyer programmes would enable (for example) a New Zealand based passenger to earn airpoints on a Cathay Pacific service to Hong Kong and redeem those points on any of Air New Zealand's domestic services. Without the alliance, New Zealand based passengers would still be able to earn frequent flyer points on Cathay Pacific's Asia Miles or Marco Polo schemes, but they would only be able to redeem the points on services by Cathay Pacific or one of its oneworld partners.
102. According to Air New Zealand, ████████ of its passengers earned or redeemed Airpoints on the Auckland-Hong Kong route in the 12 months between 1 May 2011 and 30 April 2012 (out of a total of ████████ passengers). Of these, ████████ were 'Gold' or 'Gold Elite' members.

*Access to more lower priced inventory (seat management benefit)*

103. "Seat management" is the practice of withholding a certain number of seats on a given flight until closer to the travel date, so that they can be sold at a higher rate to passengers purchasing a ticket at short (or relatively short) notice.
104. The applicants claim that by pooling capacity, fewer seats will need to be 'protected' for late booking passengers, as the capacity of both carriers can be utilised to accommodate late booking demand. According to the applicants, this will increase the carrier's average load factor, and reduce the average fare (because more discounted seats are sold without sacrificing late booking demand).
105. We accept that there is potential for consumer benefits (through greater access to lower priced seats) as a result of joint seat management. However, the extent of these benefits is unclear and largely dependent on the level of capacity that the applicants choose to provide (the applicants will have no incentive to offer additional seats in the lower fare categories if the aircraft are likely to be full).

*Cost savings and efficiencies*

106. The applicants claim that cost savings will be realised as a result of:

---

<sup>14</sup> Air New Zealand submission to the Commerce Commission, 29 June 2012

- More efficient use of each party's aircraft (i.e. "economies of traffic density" as a result of load factor improvements flowing from offering consumers a more attractive option)

- [REDACTED]

- [REDACTED]

107. Based on our analysis of New Zealand passenger arrival/departure cards, Air New Zealand's average load factor on the Auckland-Hong Kong route over the past 12 months is approximately [REDACTED], compared to [REDACTED] for Cathay Pacific. This compares to an industry average of 78.1% in 2011<sup>15</sup>. For Air New Zealand in particular, current load factors are unlikely to be sufficient to maintain a commercially viable service at current frequencies, particularly once the Hong Kong-London service ends.

108. There is clearly some scope for the applicants to achieve efficiencies through more efficient use of aircraft. However, we note that there are two ways of achieving this: load factors could be improved by offering consumers a more attractive product; but they could equally (and more easily) be improved by reducing capacity.

109. [REDACTED]  
[REDACTED]  
[REDACTED] This is expected to generate approximately [REDACTED] per annum for Air New Zealand, and [REDACTED] per annum for Cathay Pacific in revenue which would otherwise be directed to third parties.

110. [REDACTED]  
[REDACTED] Air New Zealand currently pays [REDACTED] per annum to its ground handling agent in Hong Kong, while Cathay Pacific pays [REDACTED] annually to its New Zealand based ground handling agent. [REDACTED]  
[REDACTED]

111. The extent to which these cost savings result in a benefit to consumers depends on whether the applicants elect to pass them on through reduced fares. There are no guarantees or safeguards to ensure that this occurs under the proposed alliance.

112. From a national interest perspective, there would be a small benefit as a result of Cathay Pacific purchasing lounge access from Air New Zealand (a predominantly New Zealand owned company) rather than Qantas (largely Australian owned).

#### *Future opportunities*

113. The applicants suggest that the enhanced product offering will give rise to increased load factors, which over time, will create opportunities to either increase capacity on the Auckland-Hong Kong route, or develop new routes (such as Christchurch-Hong Kong).

---

<sup>15</sup> International Air Transport Association Press Release, 1 February 2012.

114. There is no guarantee that the alliance will lead to an increase in load factors, or that increased load factors would necessarily lead to additional capacity or new route opportunities. Indeed, the purpose of our analysis is to determine whether the applicants will have an incentive to reduce capacity and/or increase fares. Without direct competition, the applicants would appear to have little incentive to establish new routes such as Christchurch-Hong Kong, which would incur additional fixed costs.

## National benefits

### *Potential for stimulation of inbound tourism through joint marketing power*

115. Airlines operating from their own hubs tend to have a significant advantage in selling tickets in the local market. This can be a result of customer loyalty to a national airline, increased brand visibility, and greater knowledge of the local customer base (leading to more effective marketing campaigns).

116. A potential benefit of the alliance is the ability for the applicants to pool marketing resources and stimulate tourism by focussing their individual marketing efforts in their respective home markets. However, the parties have not indicated any intention to enter into a joint marketing arrangement, and it is questionable whether there is much scope to increase tourism from Hong Kong through more effective marketing, given that it is a small and mature market.

### *Impact on Air New Zealand's profitability*

117. The government's ownership of Air New Zealand is not relevant to our analysis of this application. However, as the majority of Air New Zealand's profits will be retained in New Zealand, the impact that the proposed alliance may have on Air New Zealand's profitability is a relevant consideration.

118. It is likely that the proposed alliance would significantly improve the profitability of the Auckland-Hong Kong route for both carriers. However, any conclusion on the impact of the alliance on Air New Zealand's profitability needs to take into account any profits that would otherwise be gained as a result of Air New Zealand redeploying the aircraft in other markets. For this reason we have not attempted to make a judgement on the impact the alliance would have on Air New Zealand's profitability.

### *Strategic context – maintaining an Air New Zealand presence in a key Asian market*

119. New Zealand is the most remote developed country in the world relative to its international markets<sup>16</sup>. This is a significant competitive disadvantage for Air New Zealand in terms of its ability to compete in long-haul markets. Because all of Air New Zealand's routes originate in New Zealand, it is almost entirely reliant on passengers travelling between New Zealand and their origin or destination. In contrast, mid-point carriers (such as Cathay

---

<sup>16</sup> "Connecting New Zealand to the global economy" report by the New Zealand Institute, March 2007.

Pacific) are well placed to attract transit passengers travelling between any of the destinations that they serve (for example, New Zealanders travelling to the United Kingdom).

120. These challenging economics have almost certainly contributed to Air New Zealand's decisions to exit a number of key Asian markets over the last few decades – including Singapore, Taipei, Seoul, and Bangkok. Air New Zealand's argues that the main reason its existing long-haul services (other than Hong Kong) have remained viable is because each route is supported by a local carrier at the other end, supplying 'feeder' traffic. For example, services to Los Angeles and San Francisco are supported by Air New Zealand's code-share with United Airlines; the Vancouver route is supported by a codeshare with Air Canada; and services to Japan are supported by a codeshare with All Nippon Airways. The Alliance with Cathay would provide Air New Zealand with a strong partner in Hong Kong to provide feeder traffic.

121. From a consumer interest perspective, the benefits of Air New Zealand maintaining a presence in Hong Kong are relatively small provided that capacity is provided by other carriers. However, an important consideration in our analysis is whether it is relevant in the national interest to maintain the presence of the national carrier in a key Asian market. In this regard, it is notable that our International Air Transport Policy states that "we will recognise the value of a strong and competitive New Zealand-based aviation industry".

122. Air New Zealand argues that Hong Kong is strategically important, and that the alliance will enable it to leverage its position in Hong Kong to develop traffic from mainland China and other parts of Asia (such as India). We agree that, given the difficulty Air New Zealand has had in establishing viable long-haul routes, there is some benefit from a national interest perspective in ensuring that Air New Zealand (as an integral part of the New Zealand aviation industry) is able to maintain a presence in the region.

123. Currently six percent of Indian residents coming to New Zealand and one percent of New Zealanders travelling to India use Air New Zealand for the last or first leg of their journey compared to 41 percent and 50 percent respectively for Singapore Airlines.

124. While Air New Zealand would never be able to offer a service that could compete with the 81 flights a week to 10 Indian cities offered by Singapore Airlines and its subsidiary Silk Air, the opportunity under the Alliance to sell tickets at a favorable interline rate on Cathay's services from Bangalore, Chennai, Delhi and Mumbai will give Air New Zealand some presence in this important and growing market.

125. Hong Kong is Air New Zealand's main gateway for servicing Chinese markets other than Shanghai. Air New Zealand argues that

[REDACTED]

Air New Zealand [REDACTED]

[REDACTED] services to Shanghai arrive at Pudong airport, while the majority domestic services (to connecting points in China and other parts of Asia) depart from Hongqiao airport. In conjunction with the Alliance Air New Zealand would have access to a Special Prorate

Agreement providing preferential rates for it to sell flights on Cathay Pacific to 16 points in China<sup>17</sup>.

## Consumer Protection

126. Another consumer related matter to be considered when looking at alliances and code-share agreements is consumer information. Different airlines have different reputations and so it is important that consumers are aware when they are travelling on a code-share service.

127. In this regard the code-share agreements states that:

*“The Marketing Carrier shall comply with any Applicable Laws regarding the disclosure and holding out of Code-shared Flights provided for herein. The Marketing Carrier shall disclose to the extent required by Applicable Law through industry recognised schedule and selling mechanisms (as defined in the Procedures Manual) to consumers, travel agents and others selling the Codeshared Flights, as well as through any advertising, point of sale disclosures and any other appropriate means, that each Codeshared Flight is a flight of and operated by the Operating Carrier. Such information shall be given before a reservation is made and in any event at the earliest reasonable opportunity and before the passenger arrives at airport, in accordance with Applicable Law. In addition, each party shall use commercially reasonable efforts to implement procedures to disclose the Operating Carrier and the appropriate departure and arrival terminal at the earliest possible opportunity and in particular at the point of sale”.*

This is consistent with other code-share and alliance agreements which have been authorized in New Zealand.

## 9. Counterfactual

128. Given the commercial difficulties in the New Zealand – Hong Kong market outlined elsewhere in this report it is likely that the counterfactual (in other words, what the market would look like without the Alliance) is not the same as the status quo.

129. [REDACTED] More than 46% of Air NZ passengers on Auckland-Hong Kong are connecting through to London.

130. [REDACTED] Air New Zealand argues that once they drop below daily services the viability of the service will be compromised further and the inevitable result is eventual exit from the market. We agree that it is plausible that, in the absence of the alliance, Air New Zealand will reduce services and may eventually pull off the Auckland-Hong Kong route altogether.

---

<sup>17</sup> Beijing, Shanghai, Gaungzhou, Chongqing, Changsha, Fuzhou, Hangzhou, Kunming, Ningbo, Nanjing, Sanya, Qingdao, Wuhan and Xiamen.

131. Cathay Pacific contends that without the alliance [REDACTED]

132. [REDACTED]

133. The two airlines have prepared their counterfactuals separately from each other and are unaware of their respective intentions absent the alliance. We consider it unlikely [REDACTED]

134. Our view is that the likely counterfactual is that one of the airlines (most likely Air New Zealand) would withdraw from the Auckland – Hong Kong market altogether, with the other (most likely Cathay Pacific) maintaining at least a daily service.

## 10. Submissions

135. Given the confidentiality of the arrangements, we restricted consultation to a selected group of stakeholders who had taken an active interest in putting forward their views on previous Alliance arrangements. Air New Zealand separately briefed these organisations.

136. Responses were received from Auckland, Wellington and Christchurch International Airports, New Zealand Airports Association, Tourism New Zealand and the Tourism Industry Association.

137. Some submitters felt that they did not have sufficient information to comment fully. They asked for a robust cost-benefit analysis to be undertaken and to be involved in that analysis.

138. One submitter questioned if all aspects of the agreements fall within the scope of Part 9 of the Act (this issue is addressed elsewhere in this report) .

139. Several submitters commented on the applicants' definition of the market as the Pearl River Delta. It was noted that some travellers require transit visas through China. Submitters also questioned the extent to which China Southern had impacted on the applicants' services on the Hong Kong route.

140. Submitters noted the importance of Hong Kong as a route for travel to and from Europe and Asia (particularly China) and that measures that improved the sustainability of this route would be beneficial.

141. Submitters generally felt that if the alliance delivered the benefits set out by the airlines, and in particular allowed capacity and frequency on the route to be maintained, then it would be beneficial. It was noted that the likely counterfactuals (submitters did not have the airlines' confidential counterfactuals) were detrimental. The arrangements could ensure that the presence of both carriers is preserved; even if the competition between them is removed.
142. Submitters noted the benefits of connectivity and of improved prorate arrangements to China. Other submitters questioned the additional benefits given the connectivity arrangements already in place.
143. Some submitters questioned whether the airlines would have the incentive to pass benefits on to consumers, or whether the alliance would in fact allow the airlines to reduce capacity on the route. They felt that the benefits were heavily weighted towards airline benefits and that the alliance would discourage competition.
144. Some submitters felt that a firm commitment to at least maintain capacity and/or a time limitation on any approval would be needed.

## Conclusion

[To be added in final version] – In cover report

## Annex A: Statutory Criteria Analysis

### Specific Criteria in Part 9 of the Civil Aviation Act

1. This section examines whether and how the arrangements comply with Part 9 (principally section 88) of the Civil Aviation Act 1990.
2. There are two agreements at issue; the North Asia Alliance Agreement, and the Code Share Agreement (together the "Agreements").

#### Section 88(3):

***In considering whether to grant authorisation under subsection (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.***

3. The Alliance and Code-share Agreements cover services by airlines designated and operating under the Agreement between the Government of New Zealand and the Government of Hong Kong concerning Air Services done at Hong Kong on 22 February 1991 and a confidential Memorandum of Understanding [REDACTED].
4. The Memorandum of Understanding [REDACTED]
5. [REDACTED]
6. [REDACTED]
7. Authorisation of the arrangements is thus consistent with the relevant arrangements and would not prejudice compliance with them.

#### Section 88(4):

***Subject to subsection (5) of this section, authorisation shall not be given under this section to any provision of any contract, arrangement, or understanding that:***

***(a) "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"***

8. The Agreements do not contain any provisions that provide for enforcement through fines or market pressures.

***(b) Has the purpose or effect of breaching the terms of a commission regime issued under section 89 of this Act***

9. Two commission regimes issued by the Minister of Transport are currently in force - the Civil Aviation (Passenger Agents' Commission Regime) Notice 1983 and the Civil Aviation (Cargo Agents' Commission Regime) Notice 1983.
10. The references to commissions in the agreements are:

Clause 4.5(c) of the Alliance Agreement which states that cooperation “may include setting the level of any commission, rebates, or incentives payable to travel agents, or the basis on which any such commissions, rebates or incentives may be paid, to ensure that tariffs are determined consistent with the Objectives”

The definition of cost of sales costs in Schedule 3 of the Alliance Agreement which includes base commissions – “commissions retained at the point of sale by a selling agent in respect of flights on the Parties’ Alliance Routes. Includes the pro-rated Alliance element of the base commission retained in respect of multi-sector journeys. Where the parties cannot prorate the amount to the Alliance Routes, a separate agreed methodology based on allocations or specific percentage rates will be used”.

11. These provisions do not have the purpose or effect of breaching the terms of either of these commission regimes.

**(c) *Unjustifiably discriminates between consumers of international air services in the access they have to competitive tariffs***

12. The Alliance Agreement and the Code Share Agreement do not set tariffs themselves, but put in place a process for setting tariffs. The Agreements do not contain any provisions that unjustifiably discriminate between consumers in terms of this paragraph.

13. The broader issue of the impact of the Agreements on the tariffs that may be faced by consumers generally or particular classes of consumers if the Alliance is authorised, is addressed elsewhere in this report.

**(d) *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***

14. Clause 7.1 of the Alliance Agreement provides that

“Neither Party shall enter into any agreement with a third party which implement arrangements to allocate passenger revenue on routes between the Covered Jurisdictions”

15. This wording does not preclude non-revenue sharing alliances or interlining arrangements.

16. The Agreements do not impact on the right or ability of any other operating carrier, or code-share partner of another operating carrier, to enter and put tariffs in the market.

17. Thus, in relation to tariffs, the Agreements do not have the effect of excluding any supplier of international carriage by air from participating in the market to which they relate.

**(e) *Has the purpose or effect of preventing any party from seeking approval, in terms of section 90 of this Act, for the purpose of selling international carriage by air at any other tariff so approved***

18. While the Agreements contain a number of provisions relating to cooperation in the setting of tariffs (including the establishment of a Commercial Board which will reach decisions on pricing matters), there are also provisions setting out the areas in which the parties retain independence.

19. Finally, clause 12.2 of the Alliance Agreement states that:

“Both parties are free to independently seek approval, in terms of Section 90 of the Civil Aviation Act 1990 (NZ) or any other international act, for the purpose of selling international carriage by air at any other tariff so approved”.

**(f) Prevents any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding**

20. No penalty is payable when a party withdraws on reasonable notice. Section 9.3(a) of the Alliance Agreement states that:

“In the event of termination, the terminating Party shall incur no liability for any expenses, costs or damages of any kind incurred by the other Party as a consequence of such termination or any compensation by reason thereof as long as the notice of termination is given in accordance with the provisions of this Agreement”.

21. The Alliance Agreement provides for an initial 5-year term (clause 9.1). It states that following that initial term, the Agreement may be terminated by at least 6 months notice (12.2(a)) (termination to take effect at the end of the IATA scheduling season in which such notice period lapses).

22. The term of the Code Share Agreement is linked to the term of the Alliance Agreement (clause 14.1 and 14.3(a)).

23. Both the Alliance and Codeshare Agreements also provide for termination with immediate effect in the case of insolvency events, force majeure, change of ownership or other specified events.

24. While simple code-share arrangements often provide for relatively short notice periods (sometimes as short as a schedule period), Alliance arrangements often envisage and require a greater degree of commitment by the parties. Withdrawal by one party could cause considerable disruption to the other party. Therefore, longer notice periods may be appropriate.

25. In 2006, Crown Law advised that what is ‘reasonable notice’ will depend on industry practice. The Ministry has previously concluded that in some cases a period of 5 years is acceptable for more significant Alliance or code-share agreements, notably:

- Air New Zealand/United Expansion Agreement, which had a period of 4 years (4 years then 12 months notice).
- Air New Zealand/Ansett/Singapore Airlines, which had a period of 5½ years.

26. The Alliance Agreement (section 12.2(b)) and the Code Share Agreement (section 25.1) also provide that the parties can terminate early in certain circumstances including insolvency of one of the parties, change of control of one of the parties, or breach of safety obligations.

27. The Agreements do not contain any provisions that prevent any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding.

*Conclusion on section 88(4)*

28. There are no provisions in the Alliance Agreement or the Code Share Agreement that fall within any of the prohibitions in s88(4) of the Act.

**Section 88(5):**

**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.**

29. This provision only becomes relevant if, contrary to the advice set out above, you determine that provisions in the Agreements fall foul of one of the criteria in section 88(4) of the Act.
30. Comity is not defined in the Act and the Act is the only instance of the use of the term in New Zealand legislation.
31. "Comity" is defined in the Shorter Oxford (in the form of "comity of nations") as being "the courteous and friendly understanding by which each nation respects the laws and usages of every other, so far as may be without prejudice to its own rights and interests". In very similar vein is Chambers: "The international courtesy between nations in which recognition is accorded to the laws and customs of each state by others". Legal dictionaries focus more on the aspect of courts taking due notice of foreign laws and judgments. Comity is not part of international law but is regarded as important for public policy reasons.
32. Most international code-share arrangements will require approval in two jurisdictions, each with their own legislation or processes. This provision should not be interpreted to mean that New Zealand must always accept and adopt the findings of the other regulator. The two regulators will be applying different legislation. The impacts of a proposed Alliance may also be different in the two countries.
33. However in the case of an agreement with an airline from Hong Kong there is no applicable competition law.
34. We do not consider that declining to authorise any provisions of the Agreements would have an undesirable effect on international comity between New Zealand and any other State.

**Section 90:**

**Authorisation of tariffs by Minister -**

- (1) The Minister may from time to time specially authorise any tariff in respect of international carriage by air where the relevant places of departure and destination are within the territories of 2 countries, one of which is New Zealand, whether or not there is to be a break in the carriage or a transshipment.**
- (2) In giving authorisation under this section the Minister shall have regard to -**
  - (a) Whether the proposed tariff is excessive in terms of a reasonable return on investment by the supplier of the carriage; and**
  - (b) Whether it is likely that supply of the relevant carriage can be carried on for a reasonable period at the level of tariff proposed; and**
  - (c) Whether there is likely to be a substantial degree of benefit accruing to consumers generally, or to a significant group of consumers, as a result of the application of the proposed tariff,-**

***and shall ensure that the granting of such authorisation will not prejudice compliance with any international convention, agreement, or arrangement to which the Government of New Zealand is a party.***

35.



36. As set out in the discussion of subsection 88(4)(e) above, the Agreements provide that the parties may individually seek authorisation pursuant to section 90. The criteria in section 90(2) relate to individual tariffs and would be considered in the context of any such application received. The fact that many of the tariffs under the Agreements will be set by the Alliance parties together should not frustrate an assessment of an individual tariff if the situation arises.

37. The provisions of section 90 will be relevant in the event that approval is sought for an individual tariff by one of the applicants, but do not preclude authorisation of any provision in the Agreements.

**Annex B: Assessment of how sections relate to tariffs and capacity**  
**North Asia Alliance Agreement**

Introduction	Recitals	Structural
1	Definitions	Machinery
2	Commencement	Machinery
3	Objectives	Machinery. Some clauses set out what the parties hope to achieve by, inter alia, fixing tariffs and capacity – therefore indirectly relates to the fixing of tariffs and capacity
4.1	Summary of cooperation	Machinery. Sets out how the parties will work inter alia in fixing tariffs and capacity therefore relates indirectly to fixing of tariffs and capacity
4.2	Implementing agreements	Machinery – necessary for the implementation of arrangements relating to tariffs and capacity therefore relates indirectly to tariffs and capacity
4.3	Revenue sharing	Machinery. Relates directly or indirectly to the fixing or application of tariffs
4.4a	Schedule optimisation	Machinery. Relates to the fixing of capacity
4.4b	Network planning	Machinery. Relates to the fixing of capacity
4.4c	Capacity & capacity changes	Machinery. Relates to the fixing of capacity
4.4d	Parties will explore opportunities to add new routes	Machinery. Relates to fixing of capacity
4.4e	Services will be operated in accordance with North Asia Alliance Agreement and the code share agreement	Machinery. Indirectly related to tariffs and capacity
4.5	Pricing cooperation and coordinated revenue management	Machinery. Relates directly or indirectly to the fixing or application of tariffs

4.6	Harmonisation of standards & quality assurance	Machinery. Alignment of product to the extent necessary to achieve metal neutrality – relates indirectly to the fixing of capacity
4.7	Sales and marketing	Machinery. Relates to the fixing and application of tariffs
4.8	Airport operations	Machinery – assists in the smooth operation of the arrangements relating to capacity therefore indirectly related to capacity
4.9	Cost savings	Machinery. Relates directly or indirectly to the fixing or application of tariffs
4.10	Information technology	Machinery – relates indirectly to the fixing of tariffs and capacity
4.11	Product development and innovation	Machinery – relates indirectly to the fixing of tariffs and capacity
4.12	Reciprocal employee travel benefits	Machinery. Relates to fixing of tariffs (paid by staff)
5.1	Alliance governance principles	Partly machinery – sets out provisions necessary for the operation of provisions relating to tariffs and capacity.
5.2	Management teams	Partly machinery – sets out provisions necessary for the operation of provisions relating to tariffs and capacity
5.3	Delegation of powers to Management teams	Partly machinery – sets out provisions necessary for the operation of provisions relating to tariffs and capacity
6.1	Cooperation	Machinery – necessary for the implementation of the arrangements
6.2	Conditions of implementation	Machinery (not related to tariffs or capacity)
6.3	Suspension of obligations	Machinery (not related to tariffs or capacity)
6.4	Compliance with applicable law	Boilerplate
6.5	Amendment to comply with approvals and applicable law	Machinery (not related to tariffs or capacity)

7	Exclusivity	Machinery. Sets out when the parties can, and when the parties cant enter into agreements relating to the fixing of tariffs or capacity with third parties – therefore indirectly relates to the fixing of tariffs and capacity
8.1	Initial audit	Machinery – necessary for the implementation of the revenue allocation process – indirectly relates to the fixing of tariffs and capacity
8.2	Ad hoc audit	Machinery – necessary for the implementation of the revenue allocation process – indirectly relates to the fixing of tariffs and capacity
9.1	Term, Termination and Suspension	Machinery – in entering into agreements and tariffs and in particular capacity, parties need to understand what will happen if these arrangements are wound up – indirectly relates to the fixing of tariffs and capacity
10	Force Majeure	Boilerplate
11	Intellectual property and trademarks	Machinery (partly boilerplate)
12	Autonomy of parties	Machinery – helps define scope of Agreement. Section 12.2 related to tariffs
13	No capital or investment contributions	Machinery – helps define scope of Agreement (not related to tariffs or capacity)
14	Taxes	Machinery – necessary for the operation of other provisions relating to tariffs and capacity
15	Survival	Boilerplate
16	Dispute resolution	Boilerplate
17	Exclusion of consequential loss	Boilerplate
18	Confidentiality	Boilerplate
19	Notices	Boilerplate

20	Delay and waiver	Boilerplate
21	Severability	Boilerplate
22	Costs and expenses	Boilerplate
23	No third party beneficiaries	Boilerplate
24	No assignment	Boilerplate
25	Representations and warranties	Boilerplate
26	Entire agreement and variation	Boilerplate
27	Compliance with laws	Boilerplate
28	Counterparts	Boilerplate
29	Governing law and jurisdiction	Boilerplate
Schedule 1	Definitions	Machinery
Schedule 2	Routes	Machinery. Relates to the fixing of capacity
Schedule 3	Revenue allocation	Machinery. Relates to the fixing and application of tariffs
Schedule 4	Governance	Machinery – sets out provisions necessary for the operation of provisions relating to tariffs and capacity. Part B relates to tariffs and capacity
Schedule 5	Term sheets	Machinery. Other parts relate to the fixing and application of tariffs

## Code Share Agreement

Introduction		Structural
1	Definitions	Machinery
2	Codesharing and operational cooperation	Machinery. All provisions either relate directly or indirectly to the fixing of tariffs or capacity, or are machinery provisions necessary for the operation of other provisions relating to tariffs and capacity
3	Implementation and expenses	Machinery. Making clear allocation of costs within each airlines' capacity indirectly relates to the fixing of capacity
4	Inventory control and procedures	Machinery. Relates to the fixing of capacity
5	Marketing and product display	Machinery. Provisions relating to marketing and promotion, including the coordination of advertising and sales promotion of code-share flights, relate indirectly to the fixing of tariffs and capacity. Other provisions are necessary for a code-share (or at least necessary for consumer protection under a code-share)
6	Traffic document issuance, financial settlement and pricing	Machinery. All provisions relate either directly or indirectly to the fixing of tariffs or capacity
7	Training	Machinery – assists in the smooth operation of arrangements relating to tariffs or capacity
8	Security	Machinery – assists in the smooth operation of arrangements relating to tariffs or capacity
9	Safety and Maintenance	Machinery – assists in the smooth operation of arrangements relating to tariffs or capacity
9.4	Emergency procedures	Machinery – assists in the smooth operation of arrangements relating to tariffs or

		capacity
9.4.2	Additional requirements	Machinery. Relates indirectly to the fixing of tariffs and capacity
9.4.3	Request for assistance	Machinery (not related to tariffs or capacity)
10	Free and reduced rate transportation	Machinery. Relates to the fixing of tariffs and capacity
11	Intellectual property and trademarks	Machinery – relates indirectly to the fixing of tariffs and capacity
12	Representations and warranties	Boilerplate
14	Term & Termination	Machinery – in entering into agreements and tariffs and in particular capacity, parties need to understand what will happen if these arrangements are wound up – indirectly relates to the fixing of tariffs and capacity
14.5	Consequences of termination	Machinery – in entering into agreements and tariffs and in particular capacity, parties need to understand what will happen if these arrangements are wound up – indirectly relates to the fixing of tariffs and capacity
15	Indemnification	Boilerplate
16	Insurance	Boilerplate
17	Taxes	Machinery – necessary for the operation of other provisions relating to tariffs and capacity
18	Force Majeure	Boilerplate
19	Publicity	Boilerplate
20	Confidentiality	Boilerplate
21	Assignment	Boilerplate

22	Severability	Boilerplate
23	Further Assurances	Boilerplate
24	Miscellaneous	Structural/boilerplate. 24.2 & 24.8 have machinery elements (not related to tariffs or capacity)
25	Notices	Boilerplate
26	Relationship of the parties	Boilerplate
27	Governing law and dispute resolution	Boilerplate
Annex A	Definitions	Structural
Annex B	Codeshared routes	Machinery. Relates to fixing of capacity

### Key

Structural: Document framework. Not related to tariffs and/or capacity

Machinery: Makes *this* agreement work. May be:

- directly related to tariffs and/or capacity
- indirectly related to tariffs and/or capacity
- not related to tariffs and/or capacity

Boilerplate: Standard provisions of a general nature not peculiar to *this* agreement. Not related to tariffs and/or capacity

## Annex C – Air New Zealand Code-share and Alliance Arrangements authorised under part 9 of the Civil Aviation Act as at September 2012

\* denotes airline is a member of the Star Alliance

<b>Airline</b>	<b>Description</b>	<b>Date Approved</b>
Qantas	Joint Service Agreement	1990s (no longer in effect)
Japan Airlines	Code Share Agreement	1990s (no longer in effect)
	Code Share Agreement	October 2007 (no longer in effect)
United Airlines*	Code Share and Regulatory Cooperation Agreement	December 1996
	Alliance Expansion Agreement	October 1999
	Alliance Expansion Agreement	February 2002
	Code Share Agreement	December 2011
Singapore Airlines	Joint Service Agreement	August 1997
TWA	Code Share Agreement	May 1998
EVA	Code Share Agreement	June 1998 (no longer in effect)
	Code Share Agreement	July 2005
Lufthansa*	Alliance Agreement	November 1998
	Alliance Expansion	April 1999
	Alliance Expansion	April 2002
Thai Airways*	Code Share Agreement	December 2001 (approved but not implemented)
	Code Share Agreement	June 2005
Mexicana*	Code Share Agreement	December 2001 (approved but not implemented)
	Code Share Agreement	February 2005
Austrian*	Code Share Agreement	October 2003
Asiana*	Code Share Agreement	June 2004 (no longer in effect)
Air Calin	Code Share – extension of period of applicability	April 2005
Air Vanuatu	Code Share Agreement	October 2006
Air China*	Code Share Agreement	November 2006
Air Pacific	Code Share Agreement	February 2007
Air Tahiti Nui	Code Share Agreement	March 2007
Air Rarotonga	Code Share Agreement	June 2007
Shanghai Airlines	Code Share Agreement	June 2007
US Airways*	Code Share Agreement	August 2007
South African Airways*	Code Share Agreement	October 2009
Continental*	Code Share Agreement	February 2010 (Continental now merged with United)
Virgin Blue	Alliance & Code Share	December 2010 (approved for 3 years)
Etihad	Code Share Agreement	March 2011
Virgin Atlantic	Code Share Agreement	March 2011
All Nippon Airways*	Code Share Agreement	March 2012

**Annex D – List of States which have been granted rights by the New Zealand government to operate to New Zealand via Hong Kong**

*Note: except for those States marked with an asterisk, services are required to begin or end in the territory of the home state*

- Australia
- Brazil (up to 3 services per week )
- Brunei\*
- Canada
- Chile\*
- China (up to 21 services per week)
- Cook islands\*
- Denmark
- Fiji
- France (up to 2 services per week, or 3 services per week with an aircraft with less than 200 seats)
- Germany
- India (up to 7 services per week)
- Ireland (subject to agreement)
- Italy (up to 3 services per week, subject to agreement)
- Japan (subject to limitations on routes to/from Tokyo)
- Korea (up to 11 services per week)
- Luxembourg
- Macau
- Malaysia
- Norway
- Russia (up to 7 services per week)
- Samoa
- Singapore\*
- Sweden
- Switzerland
- Thailand
- Tonga
- United Arab Emirates
- United Kingdom\*
- United States