

**AIR NEW ZEALAND / CATHAY PACIFIC
ALLIANCE REAUTHORISATION**

Ministry of Transport Analysis

August 2019

Contents

Executive summary	3
Introduction	4
The Applicants	5
The Alliance	6
Commercial rationale for the Alliance	8
Consultation	9
Legal framework for analysis	10
Competition analysis	11
Impact of the Alliance	28
Public benefits and detriments	37
Terms of authorisation	40
Conclusion	40
Annex One	41

Executive summary

1. Air New Zealand Limited (Air New Zealand) and Cathay Pacific Airways Limited (Cathay Pacific) have applied for reauthorisation of their North Asia Alliance Agreement, pursuant to section 88 of the Civil Aviation Act 1990. The effect of authorisation under this section is that the arrangements under the Alliance are exempt from the provisions of the Commerce Act 1986 that prohibit arrangements substantially lessening competition.
2. The Ministry of Transport recommends that the Minister of Transport authorises the North Asia Alliance Agreement.
3. We consider the Alliance has provided, and will continue to provide, benefits to New Zealand. It provides greater international airline capacity (number of seats and flights) into New Zealand and improved connectivity for passengers travelling between New Zealand and key markets in Europe and Asia.
4. There are risks that alliances can reduce competition in some markets. However, we consider that in this case these risks are outweighed by the public benefits described above.
5. We also conclude that the Strategic Alliance Agreement meets the statutory conditions allowing it to be authorised under section 88 of the Civil Aviation Act.

Introduction

6. The Minister of Transport is responsible for authorising or declining applications for airline alliances under the Civil Aviation Act 1990 (the Act). The Ministry of Transport (the Ministry) provides advice to the Minister on whether authorisation would be consistent with the criteria set out in the Act and in New Zealand's interest.
7. The effect of authorisation is that the arrangements making up the Alliance are exempt from the provisions of the Commerce Act 1986 that prohibit arrangements substantially lessening competition.
8. This report provides a detailed summary of the Ministry's analysis of the application from Air New Zealand and Cathay Pacific (the Applicants) for reauthorisation of their airline alliance, through their North Asia Alliance Agreement (the Alliance).
9. The Alliance was initially authorised in November 2012 and reauthorised in August 2015 for a period ending 31 October 2019.

Background on airline alliances

10. International aviation is governed by a global network of thousands of bilateral air services agreements between countries. These agreements often restrict the destinations airlines are able to serve and the capacity (number of seats or flights) they are able to provide. Many of these agreements also require airlines to be majority owned by nationals of their home state. This makes it difficult for airlines to merge or establish joint ventures in the same way that most other businesses can.
11. No single airline can operate every possible route in the world. However, with alliance arrangements, airlines can expand their reach by effectively combining their networks.
12. In order to overcome the restrictions imposed in bilateral air services agreements, and the inability to serve all routes with their own aircraft, airlines have developed several means of working with one another to expand their global reach. Cooperation between airlines generally takes a number of forms.
 - Interline arrangement: where one airline buys tickets for travel on another airline at a pre-determined price. This is the mechanism through which (for example) Qantas is able to sell its passengers a ticket from Melbourne to Invercargill via Christchurch, even though it does not itself operate a service from Christchurch to Invercargill.
 - Code-share arrangement: an agreement through which an airline is effectively given the ability to sell seats on flights operated by another airline as if it were operating that flight with its own aircraft. Code-share agreements are relatively common and, without additional cooperation, rarely raise competition issues unless they involve the only airlines flying a route.
 - Revenue-sharing alliance: an extensive commercial agreement in which two or more airlines agree to share revenue in one or more markets and to cooperate on all aspects of pricing, scheduling and service delivery. These arrangements are generally subject to a much higher level of regulatory scrutiny as they have the potential to reduce competition. The Air New Zealand/Cathay Pacific Alliance is a revenue sharing alliance.
 - Global airline alliance: many airlines are members of one of the three global alliance groups – Star, Oneworld and Skyteam. Members of global alliances work together to provide services to consumers, by cooperating in areas such as marketing,

scheduling, ticketing, and frequent flyer schemes. The level of cooperation differs between members. However, it is common for members of the same group to enter into interline and code-share agreements with one another.

13. Alliances can result in benefits to consumers, for example, better access to connecting flights, more choices of routes and destinations, and the ability to earn and redeem frequent flyer points across the networks of all participating airlines. Alliances also have the potential to reduce costs for airlines, which in competitive markets, results in lower airfares for consumers. However, if alliances reduce or eliminate competition in a market, this can lead to higher airfares or reduced services.
14. In principle, we have taken the view that alliances are a necessary tool for airlines (particularly those with small and remote home markets, such as Air New Zealand) to overcome restrictions imposed on them by bilateral air services agreements and to compete on a global scale. However, each alliance agreement should be carefully scrutinised to ensure it delivers benefits that counteract any negative impacts that may result from a reduction in competition.
15. The Air New Zealand/Cathay Pacific Alliance is one of the significant alliances that have been authorised by the Minister since the 2000s. Other alliances approved by Ministers include:
 - the Qantas Airways – Emirates Alliance
 - the Qantas Airways – American Airlines Alliance
 - the Air New Zealand – Singapore Airlines Alliance
 - the Air New Zealand – Air China Alliance
 - the Air New Zealand – United Airlines Alliance
 - the Air New Zealand – Virgin Australia Alliance (not in place anymore)

The Applicants

Air New Zealand

16. Air New Zealand is New Zealand's national carrier. Air New Zealand operates a fleet of approximately 113 aircraft and offers air services to 20 airports in New Zealand as well as 31 destinations internationally.
17. To strengthen and expand its international network, Air New Zealand has developed the Pacific Rim strategy, whereby it operates to key hubs and then serves points beyond those hubs, using revenue-share alliance partnerships. This has enabled it to more sustainably serve major international markets such as China, Singapore, Hong Kong and the United States.
18. Air New Zealand is a member of the Star Alliance group.
19. The New Zealand Government currently owns 52 percent of Air New Zealand shares. The airline is listed on both the New Zealand and Australian Stock Exchanges.

Cathay Pacific

20. Cathay Pacific is an international network airline based at Hong Kong International Airport. Cathay Pacific has approximately 200 aircraft, with a passenger network covering 232 destinations in 53 countries or territories.
21. Given Hong Kong's geographic location and history as a trading hub, Cathay Pacific, like Singapore Airlines, has an unusually high share of sixth freedom (transit) traffic, which accounts for ████████ of its passengers.
22. Cathay Pacific is part of the Cathay Pacific Group, along with two other airlines:
 - Cathay Dragon, a wholly-owned subsidiary of Cathay Pacific that focuses on providing services to destinations across Asia, including more than 20 cities in mainland China, and
 - AHK (Air Hong Kong), an all-cargo carrier operating regional express freight services, which is wholly-owned by Cathay Pacific.
23. Cathay Pacific is a founder member of the Oneworld global alliance and Cathay Dragon is an affiliate member.
24. Cathay Pacific announced on 27 March 2019 its acquisition of the low-cost carrier Hong Kong Express Airways Limited (Hong Kong Express) for HK\$ 4.93 billion (approximately NZ\$ 9.5 billion). Upon completion of the transaction on or before 31st December 2019, Hong Kong Express will become a wholly-owned subsidiary of Cathay Pacific.
25. Air China Limited (Air China) is one of Cathay Pacific's major shareholders, with a share of 29.99 percent. Reciprocally, Cathay Pacific is a beneficial owner of 18.13 percent of Air China.

The Alliance

Background

The 2012 authorisation

26. On 30 April 2012, Air New Zealand and Cathay Pacific submitted an application for the authorisation of a strategic alliance, which was authorised on the 1st of November 2012 by the Minister of Transport for a period of three years. The Alliance effectively started on 30 January 2013.
27. Under the Alliance, the Applicants have cooperated on all aspects of pricing and service delivery on their services between Auckland and Hong Kong. They also entered into a Special Prorate Agreement (SPA), under which Cathay sells seats on its connecting services beyond Hong Kong to Air New Zealand at preferential rates compared with standard interline rates (with Cathay Pacific likewise gaining preferential rates on Air New Zealand's domestic services).
28. At the time the application was submitted, Cathay Pacific was operating between seven and ten services per week between Auckland and Hong Kong depending on the season. Air New Zealand was operating seven services per week, with five of those services operating beyond Hong Kong to London. In an environment of high fuel costs, Air New Zealand had already decided that it would suspend its Hong Kong-London service,

regardless of whether or not the alliance with Cathay Pacific was authorised. For Air New Zealand, the alliance was critical in enabling it to retain as much of its London-bound traffic as possible.

29. At the time of this first application, we could not definitively conclude that the Alliance would deliver benefits to customers that outweighed possible anti-competitive effects because the two airlines were the only carriers on the non-stop Auckland – Hong Kong route, and were members of different global alliances.
30. Restrictions on code-sharing between Hong Kong and mainland China under our Air Services Agreement also raised concerns about whether the alliance could realise the claimed benefits.
31. However we believed that the most likely outcome without the Alliance (if the application was declined) was that [REDACTED]. More specifically, we thought that Air New Zealand [REDACTED] and that Cathay Pacific [REDACTED].
32. Therefore we concluded there would be [REDACTED]. We also concluded that a connection to Hong Kong was an important contributor to New Zealand’s connectivity and economy.
33. We determined that a three-year authorisation period would minimise the risks to New Zealand of the alliance not delivering benefits to consumers, while providing the airlines with an opportunity to demonstrate its value.

The 2015 re-authorisation

34. On 26 November 2014, the Applicants submitted an application seeking reauthorisation of the Alliance beyond the 30 January 2016 expiry date. The conduct for which reauthorisation was being sought was the same as in 2012, and there were no substantial changes to the Alliance agreement itself.
35. The reauthorisation was approved until 31 October 2019 (an additional three years and nine months). The Applicants initially sought reauthorisation for a further five years but we concluded that we should be in a position to reassess the effects of the Alliance earlier than that. This was mainly due to lingering concerns that the Alliance might take advantage of its market position by restricting supply and increasing airfares.
36. In Northern Winter 2017, Cathay Pacific commenced a new direct seasonal Alliance service between Hong Kong and Christchurch.

The current (2019) application

37. On 6 November 2018, the Applicants sought reauthorisation for a five-year period, i.e. until 31 October 2024.
38. The Applicants have argued the Ministry’s earlier concerns have not materialised and that the Alliance has been responsive to market conditions and set capacity and airfares at appropriate levels in an increasingly competitive environment.

Scope of the Alliance

39. The Alliance provides for varying levels of cooperation between the Applicants on passenger services on:
- **Alliance Routes:** being sectors operated directly between Hong Kong and New Zealand by either airline (currently Auckland – Hong Kong and Christchurch – Hong Kong)
 - **Feeder Routes:** being the domestic New Zealand sector of an international route that includes both an Alliance route and a domestic New Zealand sector connecting to an Alliance route.
40. Under the Alliance Agreement, the Applicants coordinate their capacity, scheduling and pricing to varying degrees on the Alliance Routes and Feeder routes.
41. The Agreement sets out the principles and objectives that will underlie the establishment and maintenance of cooperation between the Applicants. It also details the markets that are covered and the level of cooperation attached to those markets.
42. A number of implementing agreements support the Alliance. These include:
- **Code-Share Agreement** that covers both Alliance Routes (the Applicants do not code-share on Air New Zealand’s feeder routes or Cathay Pacific’s connecting routes beyond Hong Kong)
 - **Special Prorate Agreement (SPA)** which sets out the proportional rates, or “prorates” the Applicants will charge each other for seats on the flights they operate, on such feeding/connecting routes as the Applicants may agree. The SPA provides more favourable rates on connecting flights to certain beyond destinations within the Applicants’ respective networks
 - **Premium Customer Handling and Lounge Agreement** to provide reciprocal premium handling, including lounge access to the extent practical
 - **Frequent Flyer Programme (FFP) Agreement** to enhance the parties’ existing frequent flyer programme agreement, to the extent practical
43. The Applicants have only applied for authorisation of the North Asian Alliance Agreement, the Code-Share Agreement and the amendments to those agreements.

Commercial rationale for the Alliance

44. The Applicants state that the commercial rationale for this Alliance has not materially changed since the 2014 Application.
45. [REDACTED] (strong inbound traffic and a reliance on connecting traffic), and requires an integrated alliance form of cooperation between home carriers providing access to each other’s beyond markets in order to remain financially sustainable.
46. The Applicants state that the Alliance allows them to compete effectively with other carriers in an environment that has become increasingly competitive since reauthorisation, especially with the presence, for a time, of Hong Kong Airlines on the

Auckland – Hong Kong route, with China Southern and Hainan Airlines operating direct services into New Zealand from the Pearl River Delta region, and with Qantas operating one-stop services via the East Coast of Australia.

47. They state that the Alliance has grown point-to-point traffic on services between Hong Kong and Auckland by 20 percent, and increased capacity by 11 percent since it was last reauthorised. The Alliance has also enabled the introduction of a new Alliance seasonal route from Christchurch to Hong Kong.

Air New Zealand

48. Air New Zealand submits that the Alliance helps it maintain and grow a sustainable market presence in strategically important Asian markets in line with its Pacific Rim strategy.
49. The Alliance enables Air New Zealand's passengers to connect at better prices into a broad range of destinations through Cathay Pacific's extensive network. Air New Zealand states that this is achieved through the favourable prorates that it obtains from both Cathay Pacific and Cathay Dragon for connecting services beyond Hong Kong.
50. Air New Zealand also argues the Alliance has stimulated New Zealand tourism with a growing number of tourists travelling to New Zealand from Hong Kong (up 90% since reauthorisation). Air New Zealand states this has been achieved mainly through the marketing and promotion of New Zealand through Cathay Pacific's distribution network within Hong Kong, which Air New Zealand is able to access through the Alliance.

Cathay Pacific

51. The Alliance allows Cathay Pacific better access at lower pricing into New Zealand through Air New Zealand's domestic network (under the SPA), and increases feed through its Hong Kong hub, originating from the two entry points in New Zealand.

Consultation

52. The Ministry consulted stakeholders on the proposed reauthorisation of the Alliance, between 19 December 2018 and 22 February 2019. Submissions were received from Auckland International Airport, Tourism Industry Aotearoa and Christchurch International Airport Limited.

Auckland International Airport (Auckland Airport)

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

Tourism Industry Aotearoa (TIA)

55. TIA supports the renewal of the Alliance. It considers that the Alliance has stimulated travel to New Zealand from Hong Kong and achieved the benefits it has sought without impacting negatively on connectivity or competitiveness in the international market.
56. It pointed to the fact that tourism in New Zealand has entered a new phase where growth is less spectacular than recent years, so it is important that alliances such as this continue to support the sustainability of our air network and our national airline.

Christchurch International Airport Limited (CIAL)

57. CIAL did not provide a view on whether the Alliance should or should not be authorised. However it provided a view on the principles that alliance applications should meet. It stressed that before determining if the Alliance is in the public interest, the Ministry should demonstrate that a set of conditions, such as recent market changes and the cumulative impacts of existing alliances the Applicants are party to and that have been previously authorised by the Minister, have been met.

Legal framework for analysis

58. Our analysis relating to the proposed reauthorisation of the Alliance includes both an analysis of whether it meets the specific statutory criteria in the Civil Aviation Act, as well as a public interest assessment.
59. Section 88(4) of the Act sets out specific statutory criteria that all provisions of all applications must meet in order to be authorised. These are in the form of prohibitions (i.e. an arrangement cannot be authorised if it does specified things).
60. We previously determined that the Alliance and Code-share agreements of this Alliance satisfied these criteria. We have reviewed the amended application and have confirmed that the current versions of the agreements (which are largely unchanged) also satisfy these specific criteria and are capable of being authorised.
61. The Act does not require the Minister to authorise an application merely because it passes these statutory tests. Rather, it prescribes that the Minister “may from time to time” specifically authorise them. This implies that the Minister should only authorise the provisions of an agreement if he/she is satisfied that doing so would be in the public interest.
62. Based on this interpretation, our analysis of alliance applications has taken the form of a weighing up of the likely benefits and detriments (broadly defined). This consists of:
 - consideration of the nature and scale of any benefits to consumers and/or New Zealand as a whole that are likely to occur as a result of the alliance
 - consideration of the nature, scale and likelihood of any possible detriments or risks, including the risks to competition, that may occur to consumers and/or New Zealand as a whole as a result of the alliance
 - consideration of where this proposal sits alongside other code-share and alliance agreements in the New Zealand market
 - consideration of the counterfactual scenario (i.e. what is likely to occur if authorisation is declined)

- an overall conclusion drawing together and weighing up the factors described above.
63. Any conclusions or assertions made in this report should be considered against our assessment of the counterfactual. The Applicants each provided confidential submissions outlining their likely course of action in the event that reauthorisation is not granted. Our view on what is likely to occur under the counterfactual is provided in paragraphs 101 to 115 of this report.
64. Benefits accruing to Air New Zealand rather than to a foreign entity are considered benefits to New Zealand, unless these are to the detriment of, for example, consumers in New Zealand. Where relevant, we also take account of the impact that authorising or declining an agreement may have on New Zealand's aviation industry and our international connectivity over the long term – both of which are indirectly affected by Air New Zealand's success as a business. However, the fact that the New Zealand government owns 52 percent of Air New Zealand is not a consideration in our analysis.
65. As this application is seeking reauthorisation of an existing alliance (as opposed to authorisation of a new alliance), we have a base of evidence to draw upon. This includes data provided by the Applicants (either in their application or in response to requests we have made for additional information), and other data sources including Statistics New Zealand's International Travel and Migration database, CAPA - Centre for Aviation, and Sabre, a commercial source of airline industry data.
66. Much of our analysis focuses on assessing whether the potential benefits and risks identified in our assessment of the 2015 application have materialised. In particular, as stated in the 2015 letter from the previous Secretary of Transport to the Chief Executive of Air New Zealand, we are looking for:
- evidence that the Applicants are responding to market conditions when setting airfares, capacity, and schedules
 - evidence of connectivity benefits, particularly in the key Alliance markets (Hong Kong and Southern China) which we considered in 2015 to be the markets in which New Zealand customers were most likely to benefit from the Alliance
 - evidence that cost savings and efficiencies have been realised and are being passed on to consumers
 - any changes in market conditions that would impact upon either the prospects of market entry or the likely counterfactual scenario.

Competition analysis

67. As part of our analysis, we have reviewed how the Alliance likely affects, and will affect, competition in the market for international air services to and from New Zealand. We have defined the primary market as being the region primarily affected by scheduling, pricing and capacity coordination under the Alliance. In the context of this application, we consider the relevant primary market to be the New Zealand – Pearl River Delta region, including the routes between New Zealand and Hong Kong.
68. While routes beyond Hong Kong are not "Alliance Routes" (being covered instead by the SPA), the impact that the Alliance will have on them is a relevant consideration in our analysis since the routes from New Zealand to Hong Kong rely heavily on connecting traffic. Air New Zealand states that approximately ■ percent of its outward-bound

passengers connect through Hong Kong to access beyond markets. We have therefore also considered the impact of the Alliance on the New Zealand – China, New Zealand – Asia (other than China)), and New Zealand – Europe markets in our analysis as they cover the majority of passengers connecting via Hong Kong.

New Zealand – Pearl River Delta

69. The Pearl River Delta region includes the Special Administrative Regions (SAR) of Hong Kong and Macau, as well as parts of the Guangdong province in China (including the major cities of Shenzhen and Guangzhou). It is one of the most densely urbanized regions in the world.
70. The major cities in the Pearl River Delta are interconnected through a network of highways, high-speed railways, ferry lines and major airports.
 - Passengers can travel by rail between Guangzhou and Hong Kong in approximately 50 minutes on high speed trains, and about two hours on normal trains, and between Shenzhen and Hong Kong in 20 minutes.
 - There are frequent ferry services operated from Hong Kong International airport to many key cities in the region, such as Macao (approximately 55 minutes), Shekou (30 minutes), and Guangzhou (55 minutes).
 - A significant milestone optimising intermodal connectivity in the Pearl River Delta was the opening in October 2018 of the Hong Kong – Zhuhai – Macau Bridge, which is a 55 kilometre bridge–tunnel system connecting these three major cities on the Pearl River Delta. The bridge has cut travel time in shuttle buses or private vehicles between Zhuhai and Hong Kong from about four hours to 30 minutes. Finally, shuttle bus companies operate cheap daily services between Hong Kong Airport and Guangzhou and these take about two and a half hours.
 - The Delta is served by five key airports: Hong Kong, Macau, Guangzhou, Shenzhen and Zhuhai. Hong Kong’s role as an international air hub was once highly valued by Guangdong, which saw the city as its gateway to the outside world, but the flow has been changing, especially since the launch of Guangzhou’s new airport in 2004 and Shenzhen’s in 2013. These five major airports are all within 150 kilometres of each other and are all striving to expand.
71. Given the proximity of the airports in Hong Kong, Macau, Guangzhou, Shenzhen and Zhuhai to one another, a significant proportion of passengers coming from or going to New Zealand are likely to regard flights arriving in or departing from any of these airports as reasonably substitutable. Therefore, airlines operating flights between New Zealand and Hong Kong are likely to be constrained in their ability to increase airfares (or reduce capacity) by the existence of competitive offerings from airlines operating from the other airports in the Pearl River Delta.
72. Therefore, for the purposes of the competition analysis, the relevant geographic market includes all five airports in the wider Pearl River Delta rather than being confined to Hong Kong. Accordingly, the relevant market includes all routes flown between Auckland and the Pearl River Delta, and between Christchurch and the Pearl River Delta.

73. Although there would likely be substitutability for many passengers between the Pearl River Delta airports (e.g. Guangzhou and Shenzhen), this is not the case for all travellers. Travelling between Hong Kong and China is effectively a border crossing, and New Zealand residents must apply for a visa to do so. The cost of obtaining a visa (NZ\$ 230 for a double entry visa for New Zealand residents) and the hassle of the paperwork might deter passengers travelling to and from Hong Kong via either Guangzhou or Shenzhen. However, this would only apply to New Zealand residents with Hong Kong as a final destination.
74. Chinese nationals who are permanent residents of or settled in Hong Kong and Macau must also apply for a 'Home Return Permit' from Hong Kong or Macau to travel freely to Mainland China. In contrast, the much larger numbers of Chinese residents transiting through Hong Kong to New Zealand may stay in Hong Kong for up to seven days without a Hong Kong entry permit, so they are able to take advantage of any differences in airfares between airlines operating anywhere in the Pearl River Delta.

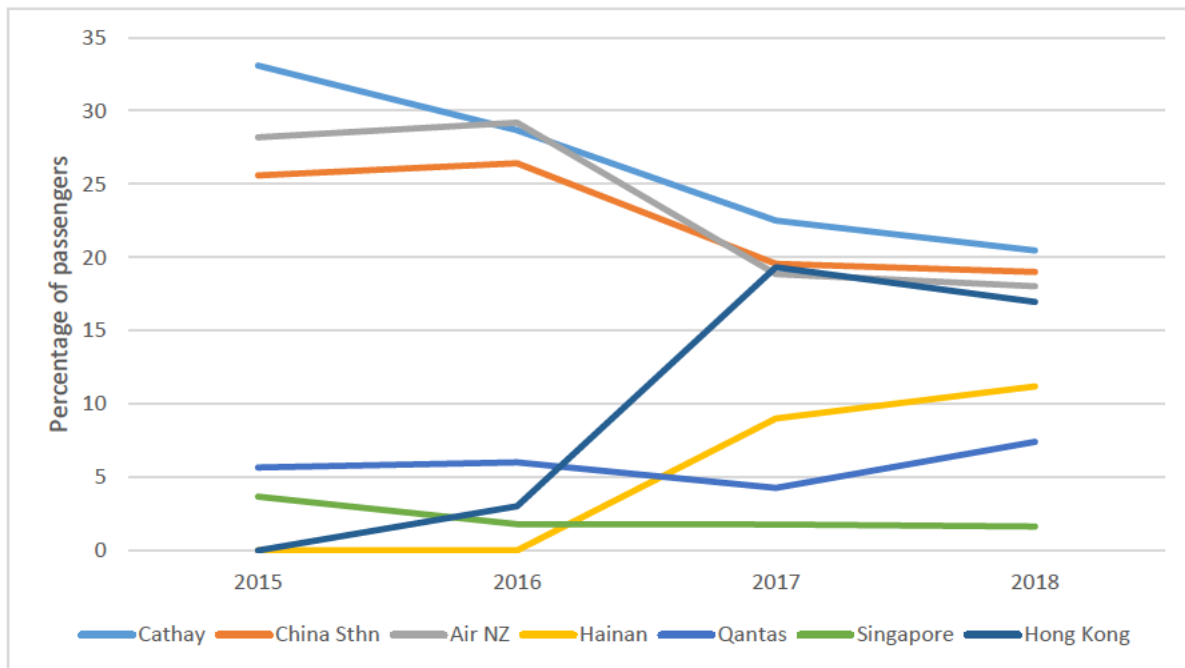
Rise of competition

75. The Applicants argue that there has been an unprecedented rise in competition and capacity to New Zealand from Hong Kong and the wider Pearl River Delta region since the Alliance was reauthorised in 2015, including increased direct and one-stop services.
76. We confirm that several carriers currently offer direct services to and from cities in the Pearl River Delta region:
- Air New Zealand and Cathay Pacific (the Alliance) on the Auckland – Hong Kong route all year round (two flights daily), and seasonally on the Christchurch – Hong Kong routes (one flight daily)
 - China Southern on the Guangzhou – Auckland route all year around, and seasonally on the Guangzhou – Christchurch route. The airline started to fly the seasonal service to Christchurch with its new Boeing 787-9 from October 2018
 - Hainan Airlines on the Shenzhen – Auckland route twice a week. Hainan Airlines recently increased capacity on this service by replacing its Airbus A330-300 with a Boeing 787 Dreamliner from October 2018.
77. Hong Kong Airlines started direct services from Hong Kong to Auckland in November 2016 but exited the route on 22 May 2019, due to network-wide losses.
78. One-stop carriers, in particular those operating via Australia, have also continued to constrain the Alliance between Auckland and Hong Kong. Air New Zealand notes that since the Alliance's reauthorisation, Qantas has increased capacity between Hong Kong and Brisbane, Melbourne and Sydney while chasing New Zealand traffic. Figure 1 shows that this resulted in a steady increase of its share of the New Zealand – Hong Kong routes in 2018. Similarly, Virgin Australia has introduced services to Hong Kong from Sydney and Melbourne but its share of the route remains relatively low at this stage.
79. Other one-stop carriers, such as Fiji Airlines, Singapore Airlines, Thai Airways, Malaysia Airlines, and Korean Airlines are also competing with the Alliance on the New Zealand to Hong Kong routes. Most of them have taken advantage of the growing

demand and increased capacity on their respective services over the reauthorisation period but their respective market shares on these routes remain quite small.

80. The market shares for each of Air New Zealand, Cathay Pacific, China Southern, Hainan Airlines, Qantas and other airlines for each of the various passenger markets are shown in Figure 1 below.

Figure 1: New Zealand – Pearl River Delta: shares by carrier (New Zealand airports to/from HKG, CAN, MFM, SZX, ZUH airports) (source: Sabre)



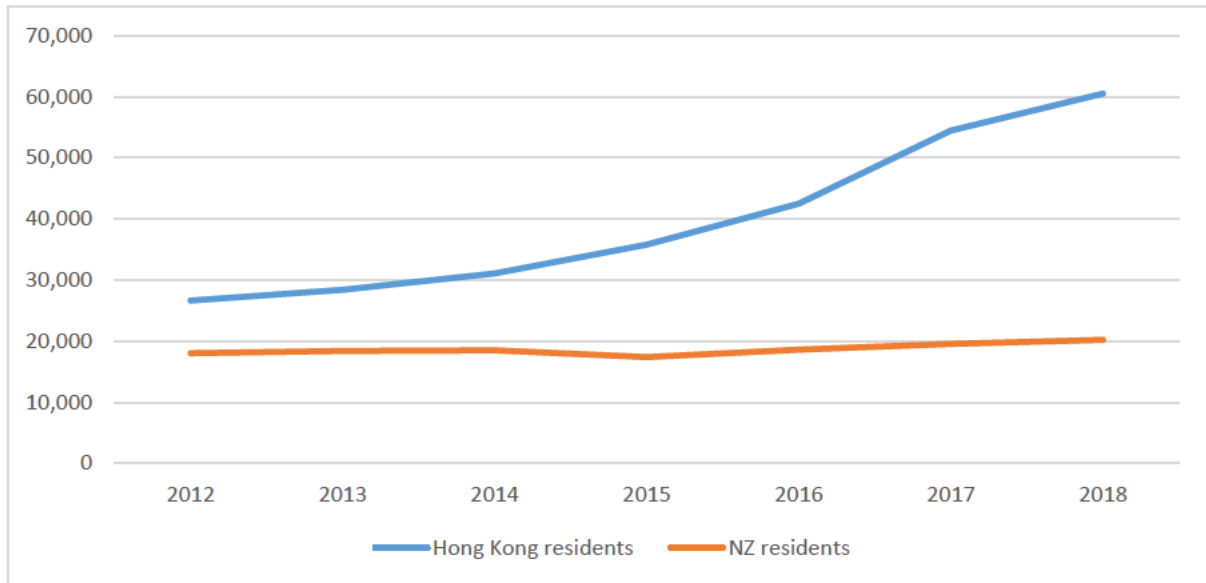
81. We note that China Southern remains the strongest competitor that the Alliance faces on the Pearl River Delta – New Zealand market. It has increased capacity on both Guangzhou – Auckland and Guangzhou – Christchurch routes during the New Zealand summers. Similarly, Hainan Airlines has started operating the Shenzhen – Auckland route in 2016, and has progressively increased capacity on the route through aircraft upgrades, resulting in a rising market share.
82. There is potential for additional competition from Chinese carriers as there is spare capacity in the New Zealand – China Air Services Agreement for airlines to increase or start new services from any point in China, including those in the Pearl River Delta.
83. In relation to airfares, the Applicants argue that the close proximity and ease of travel between Guangzhou, Shenzhen, and Hong Kong airports mean that China Southern and Hainan Airlines’ direct services to Auckland and Christchurch effectively provide direct competition to their services to Hong Kong. They argue that this would limit the Alliance’s ability to reduce capacity and/or increase airfares on the New Zealand – Hong Kong route.

84. We compared a sample of the airfares on non-stop and one-stop flights offered by various airlines on their websites, including the Applicants, from New Zealand to the Pearl River Delta region, during the same periods.
85. For example, we note that in August 2019, return tickets (roundtrip) on the Alliance services from Auckland – Hong Kong (roundtrip) vary between \$NZ 1,100-1,400 whereas return tickets from Auckland to Guangzhou on China Southern during the same period vary between \$NZ 800-1,000. Similarly, the Alliance airfares are usually higher than those of their one-stop competitors, including mainly Qantas, Virgin Australia, and China Eastern, by approximately \$NZ 200-300 for flights departing from New Zealand, and approximately \$NZ 130-150 for flights departing from Hong Kong.
86. For travel in December 2019, return tickets on the Alliance services were priced at \$NZ 1,300-1,800 whereas return tickets sold by China Southern from Auckland to Guangzhou will be between \$NZ 1,000-1,200, and return tickets sold by Hainan will vary between \$NZ 900-1,500 from Auckland to Shenzhen (and between \$NZ 700-1,000 for flights from Shenzhen to Auckland). Virgin Australia, as a one-stop carrier, offers cheaper airfares from Auckland to Hong Kong than the Alliance during this period, with airfares varying between \$NZ 1,200-1,400.
87. Also, Hong Kong, Taiwanese and Chinese residents flying from Hong Kong to New Zealand via Australia will face no additional immigration-related costs. Hong Kong and Taiwanese residents do not need to apply for a visa when transiting through Australia on their way to New Zealand, and even though Chinese residents must apply for a Transit visa, the visa is free and can be obtained relatively quickly (between nine and 19 days).
88. This analysis did not reveal pricing strategies that would have significantly affected customers' welfare or competition. One-stop flights are viable alternatives for customers who may well consider booking those instead of the Alliance services.
89. In conclusion, the competitive dynamic of the New Zealand – Pearl River Delta market has changed greatly since the initial authorisation of the Alliance, and it is clear from the data that the airlines operating the routes between New Zealand and the Pearl River Delta are competing for passengers. The Applicants appear to have taken appropriate steps to defend their market shares in response to the changing market dynamics.

The Applicants dominate the New Zealand – Hong Kong route

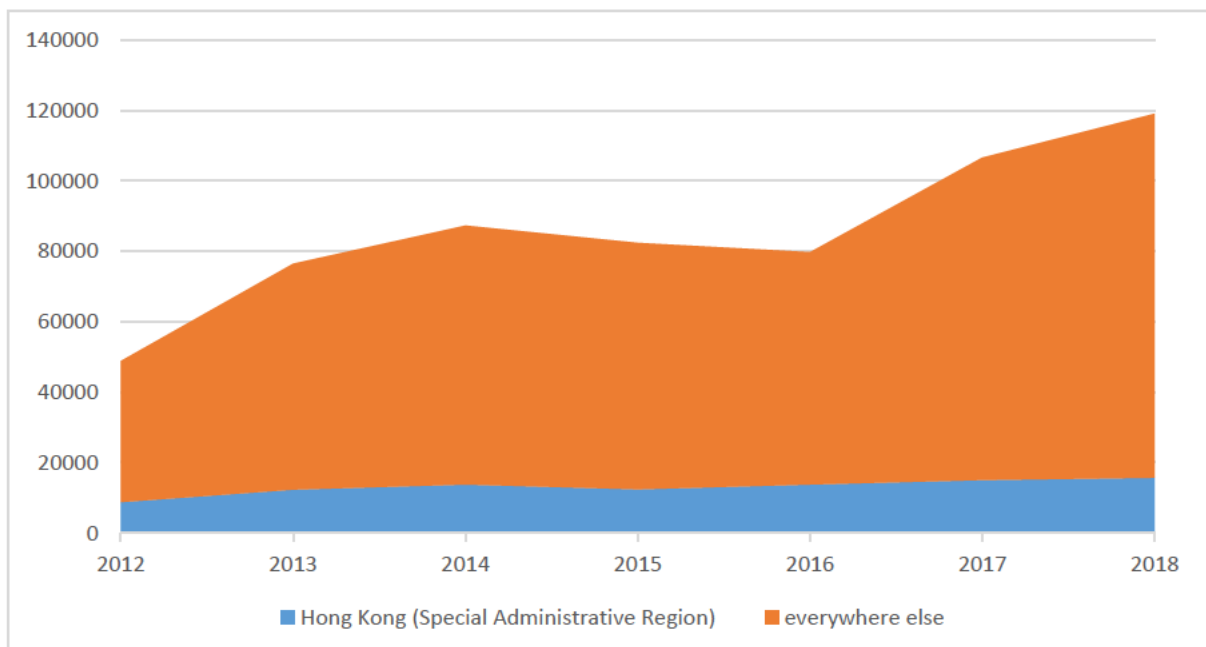
90. In his 2015 letter to Air New Zealand, the Secretary of Transport stated that the Ministry expects to see evidence that the Applicants have taken appropriate steps to defend their share of the New Zealand – Hong Kong point-to-point market. In the absence of a significant competitive response from another airline, any further reduction of share would be likely interpreted as an indication that the competitiveness of the Alliance has reduced. For this reason, we have examined the point-to-point route below, despite our focus on the Pearl River Delta as the primary relevant market.
91. Point-to-point demand for travel between Hong Kong and New Zealand is steadily growing. In 2018, Hong Kong was the 11th largest source of tourists to New Zealand. An estimated 58,763 Hong Kong residents travelled to New Zealand in 2018 while 20,402 New Zealanders travelled to Hong Kong as their main destination during the same period.

Figure 2: New Zealand – Hong Kong to point-to-point traffic, years ended October (source: Stats NZ)



92. The majority of New Zealand residents travelling to Hong Kong use it as a transit point for travel to destinations beyond Hong Kong. As shown in Figure 3, point-to-point travel makes up approximately 13 percent of New Zealand traffic to Hong Kong.

Figure 3: New Zealand residents travelling to/connecting via Hong Kong (source: Stats NZ)



93. Air New Zealand and Cathay Pacific are currently the only two carriers operating direct services between New Zealand and Hong Kong. Cathay Pacific operates daily to Auckland as well as three days per week to Christchurch during the New Zealand

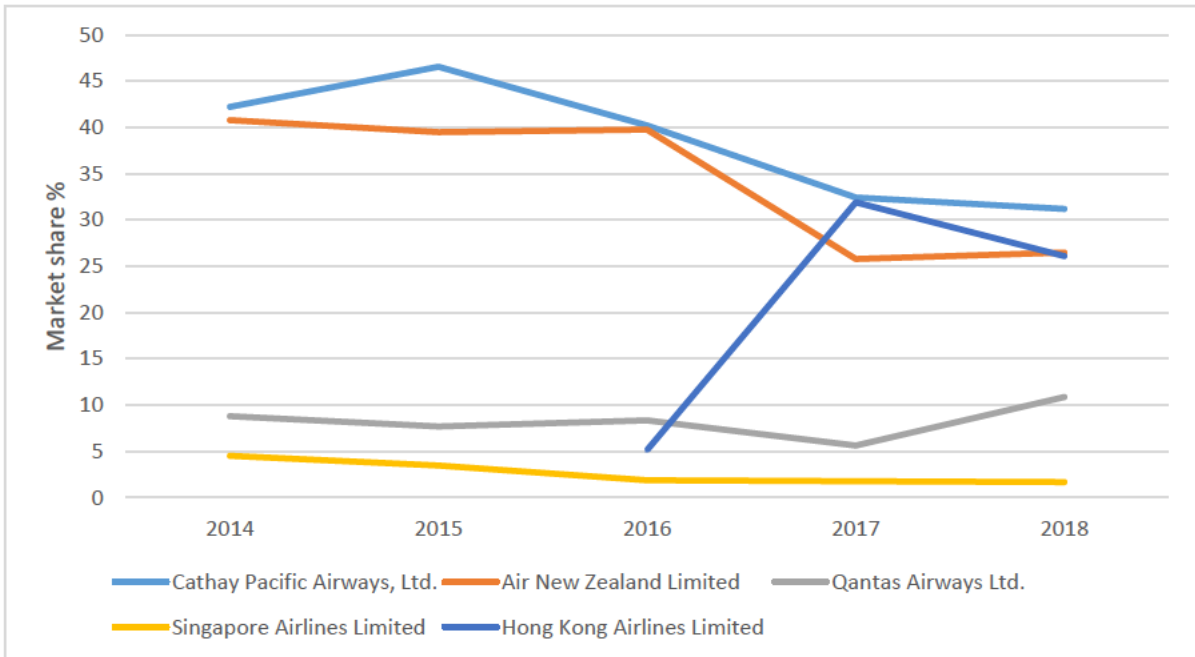
summer (IATA Northern Winter season). Air New Zealand operates daily services between Auckland and Hong Kong all year.

94. The Alliance effectively removes direct competition between the Applicants on the Alliance sectors, which include the New Zealand – Hong Kong routes. However, this dominance does not extend to the relevant market, which is the wider Pearl River Delta, as explained above.
95. As noted above, Hong Kong Airlines started to compete head-to-head with the Alliance in November 2016 on the Auckland – Hong Kong route, but announced its withdrawal from the route following a review of its broader network and an adjustment of its overall business strategy. The airline discontinued services between Hong Kong and Auckland on 22 May 2019.
96. As shown in Figure 4 below, during these three years of operation, Hong Kong Airlines managed to draw significant traffic from the Alliance with a share of the route reaching 31.9 percent in 2017, before falling slightly to 26 percent in 2018. In 2016 (the year of Hong Kong Airlines' entry), Air New Zealand and Cathay Pacific had a combined share of 79.4 percent in 2018, which fell sharply to 57.7 percent in 2017.
97. The Applicants currently have a lower share of the New Zealand – Hong Kong routes than in the year prior to the Alliance when they were competing with each other. Indeed, in the 2011 calendar year (pre-authorisation), Cathay Pacific had 44.5 percent and Air New Zealand 37.2 percent shares, while in 2018, Air New Zealand and Cathay Pacific held a combined 57.7 percent share of the routes.
98. However, we note that before Hong Kong Airlines' entry, in the 2015 calendar year, the Alliance's market share of New Zealand – Hong Kong passengers was 85.9 percent, higher than before the Alliance was implemented (81.7 percent when combining the shares of the Applicants pre Alliance). Considering this, we believe that Hong Kong Airlines' exit is likely to result in a rebound of the Applicants' combined share of the New Zealand – Hong Kong routes, perhaps to 2015 levels.
99. It is difficult to foresee greater competition on the non-stop route between New Zealand – Hong Kong going forward for the following reasons:
 - there are only four Hong Kong-based scheduled carriers (Cathay Dragon, Cathay Pacific, Hong Kong Airlines, and HK Express). As stated in paragraphs 22 and 24, Cathay Dragon is Cathay Pacific's subsidiary and HK Express will become one in December 2019. Hong Kong Airlines is no longer a competitor to the Alliance since it stopped operating to New Zealand in May 2019.
 - as highlighted in our 2012 and 2015 reports, [REDACTED]. Even if a number of third country airlines hold the necessary traffic rights to operate between Hong Kong and New Zealand, catering for a market as small and isolated as New Zealand on a fifth freedom basis is often seen as being too risky and not viable.
 - the Alliance provides the Applicants with significant competitive advantages that would be difficult for other carriers to replicate (e.g. home-based at both

ends, ability to coordinate pricing and scheduling). Therefore, the Alliance might make it more difficult for other airlines to enter the New Zealand – Hong Kong routes.

100. As analysed in the previous section, one-stop carriers, especially Australian airlines, have been effectively competing with the Alliance between Auckland and Hong Kong and one-stop flights are viable alternatives for consumers travelling on this market.

Figure 4: New Zealand – Hong Kong route: shares by carrier (source: Sabre)



Counterfactual

101. This part of our analysis is the counterfactual, i.e. the likely scenario that would occur if the Alliance is not reauthorised.
102. Each Applicant has provided its own confidential analysis of the likely scenario in case of decline. Both airlines’ counterfactual submissions are very similar to those submitted in 2014 and 2015.

Air New Zealand

103. Air New Zealand states in its submission that absent the Alliance, its operations on the Auckland – Hong Kong route would [REDACTED]

[REDACTED]

104. [REDACTED]

105. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

106. [REDACTED]
[REDACTED]
[REDACTED].

Cathay Pacific

107. Absent the Alliance, Cathay Pacific states that it [REDACTED]
[REDACTED]
[REDACTED].

108. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

109. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

110. [REDACTED]
[REDACTED]
[REDACTED].

Ministry of Transport assessment

111. We accept Cathay Pacific's claim that, absent the Alliance, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

112. [REDACTED]
[REDACTED]
[REDACTED]. Air New Zealand might find it hard to compete on the route given Cathay is likely to have more attractive take-off and landing slots and offer better onward connections than Air New Zealand could offer under a traditional SPA agreement with Cathay Pacific or other competing airlines operating to Hong Kong.

113. We accept that, absent the Alliance, Air New Zealand might [REDACTED]
[REDACTED]
[REDACTED].

114. To summarise, we consider it [REDACTED]. Our view is that Cathay Pacific [REDACTED], and that Air New Zealand [REDACTED].
115. As in our 2015 report, we do not rule out the fact that Air New Zealand could explore new partnership options with other airlines in the Asia Pacific market to maintain a strategic market presence in Southern China and North Asia. [REDACTED]. We are aware that developing new arrangements can be time-consuming, costly, difficult to negotiate and might not provide the same benefits as those provided under the Alliance but these remain possibilities.

Recent policy changes that could impact on the Alliance

New Chinese aviation policy

116. The Chinese government recently decided to ease its long-standing “one [city-to-city] route, one [Chinese] airline” policy for Chinese airlines to allow for increased competition on long-haul international routes. The revised policy and new related rules came into force on October 1, 2018.
117. The revised policy allows Chinese airlines to compete against each other on 20 international routes that have at least 14 weekly flights. Each of the Chinese Airlines flying into New Zealand are flying from different Chinese cities to either Auckland or Christchurch.
118. The Civil Aviation Administration of China (CAAC) has suggested that the pending opening of the new Beijing Daxing International Airport was a catalyst for the government’s decision to change the route policy. In the event that several Chinese airlines compete for a slot, CAAC will adopt a set of quantitative indicators to assess their capability, including the potential benefit they bring to consumers, their contribution to the construction of an airport hub, usage rate of freedoms of the air, service quality, etc.
119. Further analysis is needed to understand the impact of the revised policy on the Alliance but we could reasonably expect the Applicants to face more competition from Chinese carriers in the next few years on the New Zealand – Pearl River Delta routes as well as on routes beyond to Europe and Asia. The central government may look to permit new routes or allow more airlines to compete on existing profitable routes, including those to New Zealand.
120. We also expect this year will see more industry rationalisation, with some loosening of regulatory restrictions on route competition amongst Chinese carriers and the announced cessation of subsidies for long-haul flights from second-tier Chinese cities. These subsidies, which were made available in 2016 by various provincial and local government authorities to incentivise Chinese airlines to open long-haul routes, including flights to New Zealand, are due to terminate by the end of 2019.

Hong Kong unchanged policy framework

121. The aero-political situation of Hong Kong has remained unchanged since the first authorisation of the Alliance in 2012. [REDACTED]

[REDACTED]

122. [REDACTED]

Strong competition on the ‘beyond routes’ covered under the Alliance

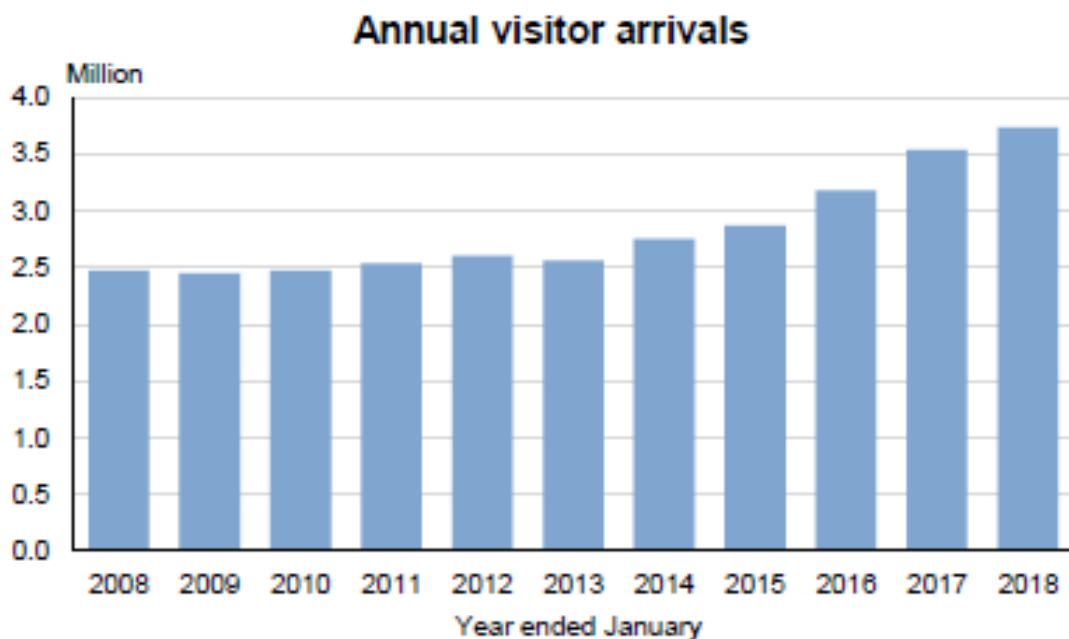
123. As noted in paragraph 68, the New Zealand – Europe, New Zealand – China (other than the Pearl River Delta) and New Zealand – Asia (other than China) markets are also relevant considerations to the analysis. These markets, covered under the SPA, are the most popular ones among the Alliance passengers connecting beyond Hong Kong (■ percent of Air New Zealand passengers connect beyond Hong Kong).

124. The Applicants do not codeshare on beyond destinations but the Alliance includes an SPA that provides favourable rates on connecting flights to certain beyond destinations within the Applicants’ respective networks (an SPA is a lower level of coordination than a code-share).

Total passenger numbers in ‘beyond’ markets covered under the Alliance have increased

125. As shown in Figure 5 below, the number of visitors arriving in New Zealand (from all countries) has grown significantly since 2014. In the year ending December 2018, there were estimated international visitor arrivals of 3,863,000, an increase of approximately 30 percent.

Figure 5: Annual visitor arrivals in New Zealand (source: Stats NZ)

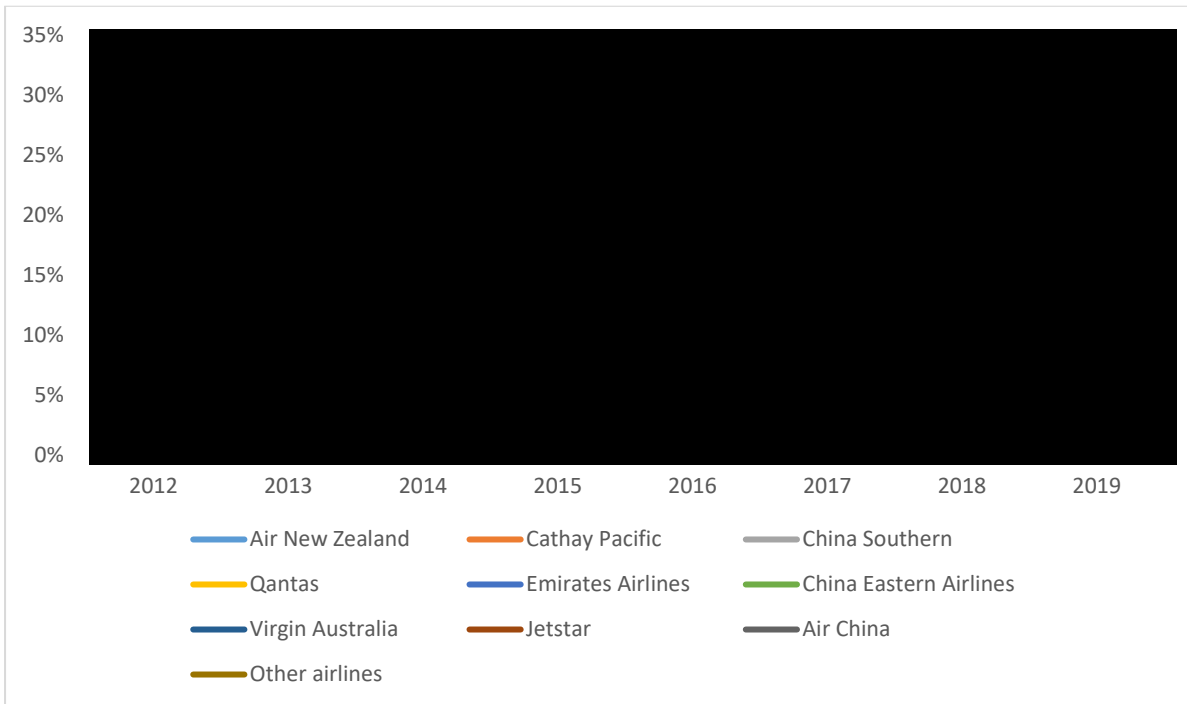


126. International visitor arrivals to New Zealand are forecast to reach 5.1 million visitors in 2024 (up 37.1 percent from 3.7 million in 2017). This equates to a growth rate of 4.6 percent per year. Along with this growth, the international spend is forecast to reach nearly \$NZ 15 billion by 2024, equating to a 4.9 percent growth rate per year.
127. This growth is mainly driven by strong growth in Asian markets, especially China, and continued growth in established markets such as Australia, the United Kingdom and South Korea. In particular, China, currently New Zealand's second-largest tourism market in terms of both arrivals and spend, is expected to grow strongly during the forecast period, overtaking Australia as the largest market by 2024.
128. The general increase in passengers from the core Alliance 'beyond' markets, including China, the United Kingdom and other European countries is positive for the viability of the Alliance.

New Zealand – China

129. As mentioned above, China remains an important origin and destination for passengers travelling on the Alliance services.
130. Air New Zealand explained that the Alliance is its best option [REDACTED]
[REDACTED]
[REDACTED]
131. Air New Zealand defined 'Southern China' for the purpose of this Application as including Changsha (Hunan region), Xiamen (Fujian region), Guangzhou (Guangdong region), Fuzhou (Fujian region), Guilin (Guanxi region), Haikou (Hainan region) and Sanya (Hainan region). Air New Zealand stated that over [REDACTED] percent of Air New Zealand passengers connecting into Southern China on the Alliance services were going to these cities as their final destination.
132. As shown in Figure 6 below, the New Zealand – China market is quite competitive. Passengers travelling in the New Zealand – China market are able to choose from a range of direct services from Shanghai (on the Air New Zealand/Air China alliance), Beijing (Air China), and others. There are also alternative one-stop services offered by airlines, mainly via Australia, but also from other points in Asia.

Figure 6: New Zealand – China market shares by carriers (source: Stats NZ)



133. Air New Zealand and Cathay Pacific’s respective market shares have both decreased between 2015 and 2019. Air New Zealand share is around █ percent in 2019 compared to █ percent in 2015, and Cathay Pacific share is estimated at █ percent in 2019 compared to █ percent in 2015. These decreases are explained by the increase in competition on this market, and it is clear that the Alliance has not lessened competition in these markets.

134. We also analysed the extent of the overlap between the alliances Air New Zealand has concluded with Cathay Pacific and Air China, and the potential anticompetitive behaviours this could trigger in the China – New Zealand market.

135. We concluded that, at this stage, the overlap between the markets served by the two alliances remains minimal. The two alliances operating simultaneously do not restrict competition in the China – New Zealand market.

New Zealand – Europe

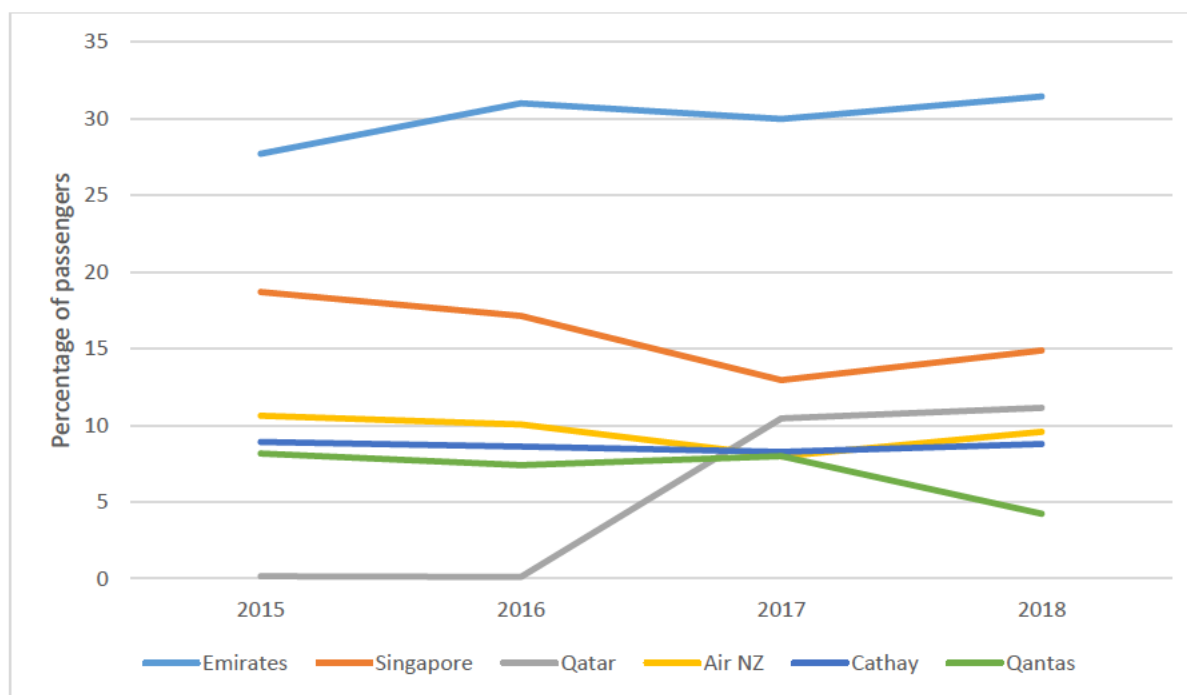
136. New Zealand – Europe is a large market for the Alliance and for New Zealand. In the year ended March 2019, as many as 558,681 passengers flew from Europe to New Zealand, a 26 percent increase since 2015. Similarly, 264,525 New Zealanders travelled to Europe that year, a 21 percent increase since 2015.

137. The United Kingdom remains the most important European route for the Alliance. █
 █. Other European destinations including █ are also covered under the SPA.

138. As shown in Figure 7 below, the New Zealand – Europe market has been competitive during the period of the Alliance and has generally been well served by a number of

airlines offering one-stop services through hubs in Southeast Asia, the Middle East, North America, and Northern Asia.

Figure 7: New Zealand – Europe: shares by carrier (source: Sabre)



139. Air New Zealand had an 11 percent market share in 2015 while Cathay Pacific’s was approximately nine percent. As shown in Figure 7, the airlines’ respective market shares have remained stable over the period of reauthorisation – in the calendar year 2018, Air New Zealand had lost one percent market share and Cathay Pacific’s market share was still nine percent.

New Zealand – Other Asia

140. Air New Zealand states that it has sought to increase connectivity into other beyond destinations to support the traffic on the Alliance routes, [REDACTED].

141. The Alliance SPA covers a range of Asian destinations other than China, [REDACTED].

142. Figure 8 below shows the market shares of airlines competing on the New Zealand – Asia (excluding China) routes.

Figure 8: New Zealand – Other Asia market shares by carrier (year ended March 2019)
(source: Stats NZ)

	India	Korea, Republic of	Malaysia	Philippines	Singapore	Taiwan	Thailand	Viet Nam
Air New Zealand	██████	██████	██████	██████	██████	██████	██████	██████
Cathay Pacific	██████	██████	██████	██████	██████	██████	██████	██████
Singapore Airlines	██████	██████	██████	██████	██████	██████	██████	██████
China Southern	██████	██████	██████	██████	██████	██████	██████	██████
Malaysian Airlines	██████	██████	██████	██████	██████	██████	██████	██████
Qantas	██████	██████	██████	██████	██████	██████	██████	██████
Air Asia X	██████	██████	██████	██████	██████	██████	██████	██████
Hong Kong Airlines	██████	██████	██████	██████	██████	██████	██████	██████
Jetstar	██████	██████	██████	██████	██████	██████	██████	██████
Virgin Australia	██████	██████	██████	██████	██████	██████	██████	██████
Thai Airways International	██████	██████	██████	██████	██████	██████	██████	██████
China Airlines	██████	██████	██████	██████	██████	██████	██████	██████
Philippine Airlines	██████	██████	██████	██████	██████	██████	██████	██████
Emirates Airlines	██████	██████	██████	██████	██████	██████	██████	██████
LAN Chile	██████	██████	██████	██████	██████	██████	██████	██████
Korean Air	██████	██████	██████	██████	██████	██████	██████	██████
Air China	██████	██████	██████	██████	██████	██████	██████	██████
Other airlines	██████	██████	██████	██████	██████	██████	██████	██████

143. Cathay Pacific does not hold large shares in the markets listed in Figure 8. Air New Zealand holds ██████ percent share in the ████████████████████ and ██████ percent in the ████████████████████.
144. Air New Zealand began operating a point-to-point service to Taiwan in November 2018 – ████████████████████. Air New Zealand’s market shares are not surprising for a home carrier serving long thin routes.

145. Given Cathay Pacific’s market shares, we do not consider that the Alliance leads to a lessening of competition in these markets. The Asia Pacific market is currently the fastest growing market globally, and we expect competition to increase over time.

Upcoming network changes

146. Since the submission of this application, Air New Zealand has announced changes to its network with the stated aim of stimulating tourism to, from and within New Zealand, and by flying into new markets with the launch of additional destinations and increased frequencies, including:

- new direct services between Auckland and Seoul from late November 2019
- increased frequency on Auckland-Taipei services from November 2019 and Auckland-Chicago services from December 2019.

147. These initiatives have demonstrated that the Alliance is not an impediment to Air New Zealand expanding its own network in opening new direct routes from New Zealand, which have until now, been served only through the Alliance’s network via Hong Kong.

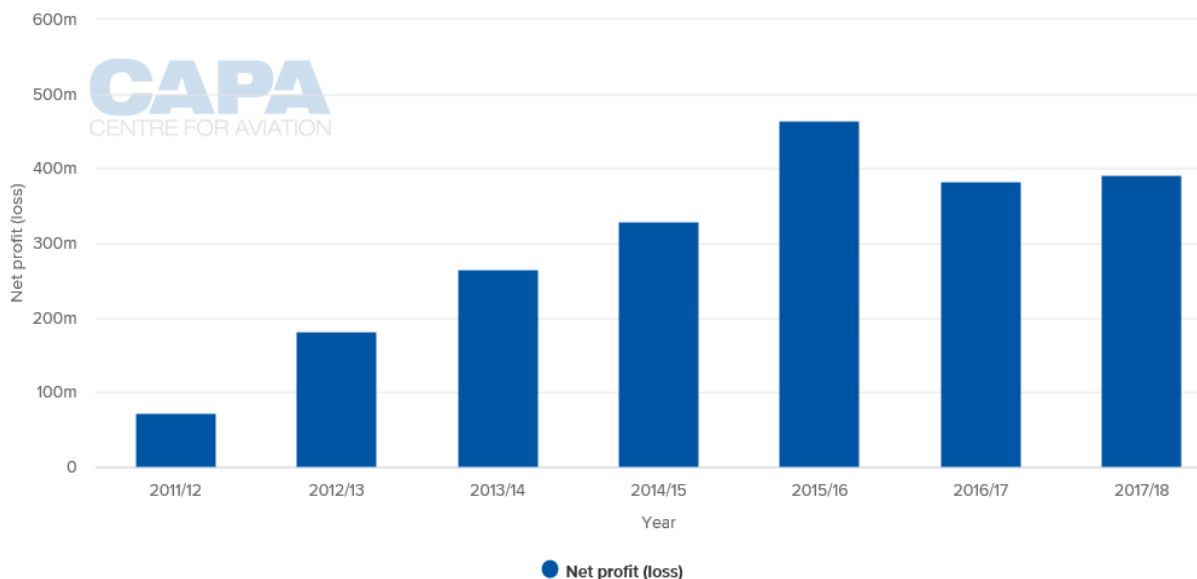
Air New Zealand strategic partnerships in the Asia Pacific market

148. As stated in paragraph 15, Ministers of Transport have approved three strategic alliances between Air New Zealand and Asian airlines.

149. Air New Zealand’s profitability has significantly improved since the airline started its alliance strategy within the Pacific Rim network as shown in Figure 9 below. There was a 4.5 percent increase between the 2011 - 2012 and 2017 - 2018 financial years.

150. We note that Air New Zealand recently announced an interim profit of \$NZ 211 million – down 35 percent on the previous year – and a stable interim dividend of 11.0 cents per share. Air New Zealand has recently faced some operational challenges, mainly related to the increases of both fuel price and operational costs, and is undergoing some restructuring.

Figure 9: Air New Zealand net profit from 2011 to 2018 in \$NZ (source: CAPA)



151. Air New Zealand has used each of its alliances to access different parts of Asia from its partners' hubs that would be otherwise difficult to connect with New Zealand. The three alliances currently operating in the Asia Pacific aviation market are:
- Singapore Airlines – Air New Zealand alliance provides access to a number of markets via Singapore, including Europe, South East Asia, India and South Africa. Access to these markets is mainly granted through [REDACTED]. This alliance was initially authorised in August 2014 and is currently authorised until 2025.
 - Air China – Air New Zealand alliance provides for coordination on non-stop daily flights between Auckland and Shanghai, and non-stop flights from Auckland to Beijing. The focus of this alliance is point-to-point traffic between New Zealand and the large catchment areas of Shanghai and Beijing. This alliance was approved in September 2015 and has been authorised until 31 March 2021.
 - Cathay Pacific – Air New Zealand alliance focuses on [REDACTED].
152. We were concerned that there could be some important overlaps between the alliances' operations, leading to a lessening of competition. This was mainly due to the airlines involved (i.e. corporate structure, ownership and control) as well as the proximity of the alliances' respective networks and operations.
153. Air New Zealand stated that under the Air China – Air New Zealand alliance, less than [REDACTED] percent of Air New Zealand passengers connect onto Air China's network to Southern China. The alliance with Cathay Pacific should be seen as complementary to the alliance with Air China, as it enables Air New Zealand to connect into mainland China, outside of the catchment areas of Beijing and Shanghai, and to enter into markets that would otherwise be difficult to reach. [REDACTED].
154. We conducted a comparative analysis of the networks flown by the two alliances to assess the extent of the overlap, both in terms of city pairs flown and capacity deployed by Air China and Cathay Pacific. We concluded that China (including the Pearl River Delta) could effectively be divided into several separate relevant markets, so that having two alliances to cover these markets is appropriate.
155. As for the Singapore Airlines – Air New Zealand alliance, [REDACTED]. We concluded that the main overlaps were in the beyond markets, i.e. New Zealand – Europe (in particular London) and some Asian countries such as the Philippines and Vietnam [REDACTED]). However, we concluded that, while overlaps exist in some markets that both alliances operate in, we consider the markets are competitive enough to prevent the alliances possessing market power.
156. We conclude that the overlaps between the three alliances do not negatively impact on competition at this stage. These alliances have greatly increased capacity between

New Zealand and the rest of the world, and provided more choice to passengers travelling to and from New Zealand.

Impact of the Alliance

157. The following paragraphs analyse the impact the Alliance has had on various aspects of performance, such as capacity, load factors, airfares and others.

The Alliance capacity has increased

158. In our report on the first re-authorisation, we noted that the total seat capacity on the Auckland – Hong Kong route had decreased by 4.7 percent over the duration of the Alliance. This was considered to be an unsatisfactory outcome, and detrimental to passengers.

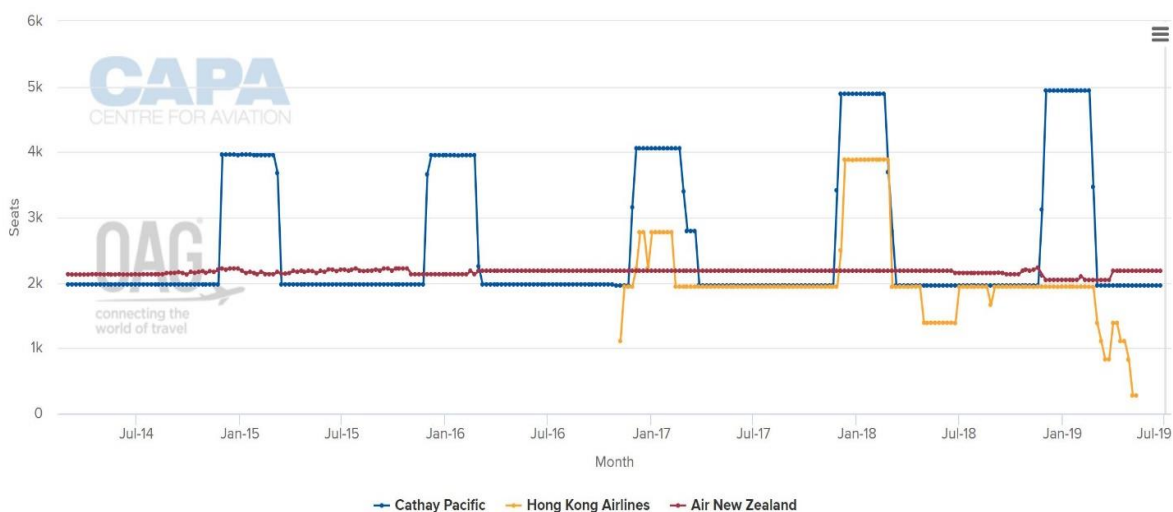
159. This was due to two factors:

- Cathay Pacific's introduction of premium economy class onto its aircraft (which reduced the total number of seats)
- Cathay Pacific's reduction of the length of its 'peak' season, resulting in significant loss of capacity throughout March.

160. One of the factors the Ministry said it would consider when assessing the application for reauthorisation of the North Asia Alliance Agreement was an expectation that the Alliance will be responsive to market conditions, and act in a competitive manner when setting capacity on the Auckland – Hong Kong route. This also meant that consumer benefits of the Alliance would be reflected in an increase in capacity and passenger volumes on the Alliance services across the relevant markets, including Hong Kong and Southern China.

161. The Applicants state the Alliance capacity in available seat kilometres (ASK) between New Zealand and Hong Kong has increased by 11 percent since reauthorisation, i.e. from Year 2 of the Alliance (1 February 2014 – 31 January 2015).

Figure 10: Airlines capacity on Hong Kong – New Zealand routes (source: CAPA)

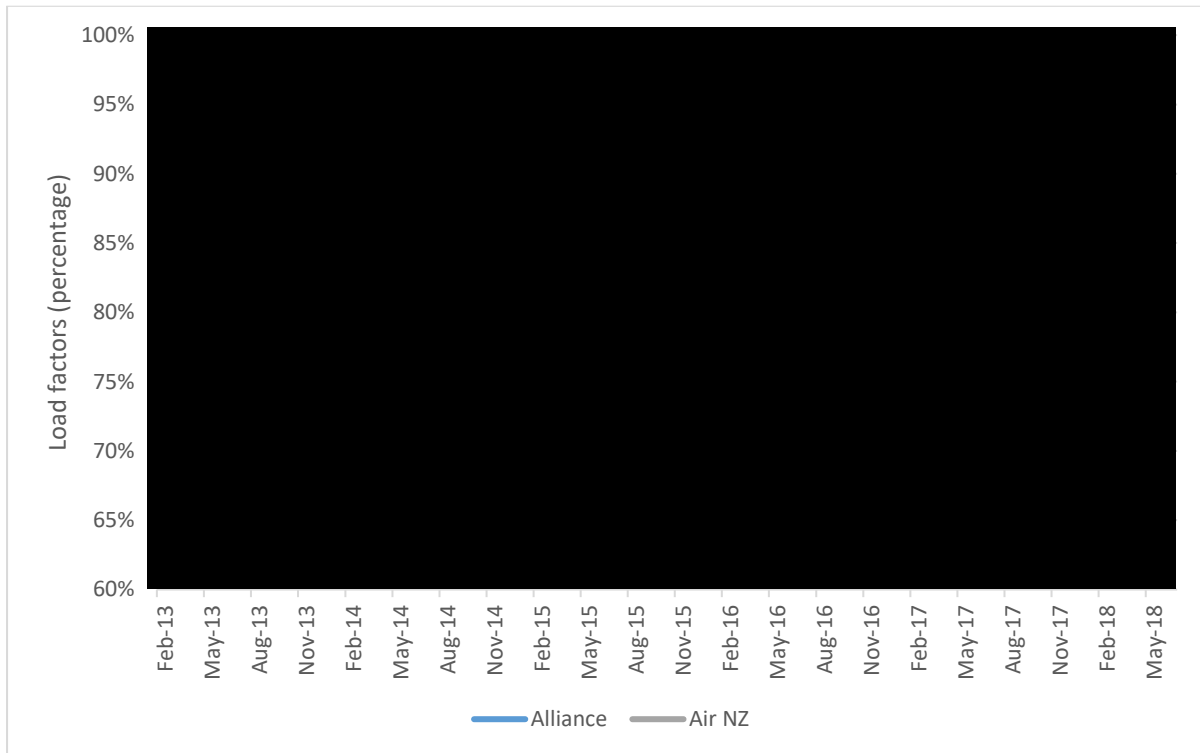


162. Figure 10 above confirms some increase of the Alliance capacity, but only in the summer peaks, all of which has been provided by Cathay Pacific.
163. This is the result of several factors:
- the up gauge of one of Cathay Pacific's daily services from the A340-400 to the B777-300ER aircraft, which have 75 additional seats
 - the replacement of its A340 fleet with A350 aircraft
 - the introduction of the new seasonal route from Christchurch to Hong Kong in the IATA Northern Winter 2017.
164. We can also confirm that the Applicants have been able to maintain passenger volumes on Alliance services across the relevant markets in spite of the entry, for a time, of Hong Kong Airlines on the Auckland – Hong Kong route and China Southern and Qantas' increases of capacity during the period of reauthorisation.

Alliance load factors have been relatively steady since reauthorisation

165. In our 2015 report, we were of the view that load factors within the 75 – 85 percent range were acceptable for airlines. We were however concerned that increasing load factors were influenced by a reduction in the Alliance's capacity, and that this could consequently result in increased airfares, above competitive levels.
166. In their current application, the Applicants state that the Alliance load factors remain in the 75-85 percent range and added that increased load factors are indicative of improved operational efficiency (mainly through better seat management) rather than constrained capacity.
167. As global passenger demand continues to increase load factors are also trending upwards. IATA states that industry-wide ASKs grew by 5.5 percent from August 2017 to August 2018, accompanied by an increase of 0.7 percent of the industry-wide passenger load factor to 85.3 percent in August 2018 – an all-time record according to the organisation. More specifically, in the Asia Pacific region, passenger load factor rose from 82.6 percent to 84.3 percent.
168. As shown in Figure 11 below, load factors on the Alliance services [REDACTED].

Figure 11: Load factors, North Asia Alliance (source: Air New Zealand data)



169. Considering the increased capacity and the ongoing global upward trend in load factors, we consider the Alliance load factors have been at acceptable levels.

Airfares on the Alliance services have not increased

170. The Applicants note the average point-to-point airfares from New Zealand have fallen approximately █ percent, and approximately █ percent from Hong Kong point of sale since the Alliance started (adjusted for inflation). More recently, average airfares have fallen by █ percent and █ percent from Hong Kong and New Zealand points of sales respectively following reauthorisation. While Hong Kong Airlines was in the market, average airfares decreased even further.

171. Data provided by the applicants shows that, since the first year of the Alliance calendar year 2015, for tickets sold from New Zealand:

- Alliance economy class airfares have decreased by █ percent
- Alliance premium economy airfares have decreased by █ percent
- Alliance business class airfares have decreased by █ percent.

172. Similarly, for tickets sold from Hong Kong point of sale over the same period:

- Alliance economy class airfares have decreased by █ percent
- Alliance premium economy airfares have decreased by █ percent
- Alliance business class airfares decreased █ percent.

173. The Applicants also argue that the Alliance airfares have been set at competitive levels over the course of the Alliance. [REDACTED]

[REDACTED]

174. Figures 12 and 13 below show the average airfares on these routes, sold respectively by Air New Zealand and Cathay Pacific, in both New Zealand and Hong Kong points of sale since the Alliance commenced.

Figure 12: Air New Zealand average airfares sold on the New Zealand – Hong Kong route (incl. Christchurch – Hong Kong from March 2018) (source: Applicants data)

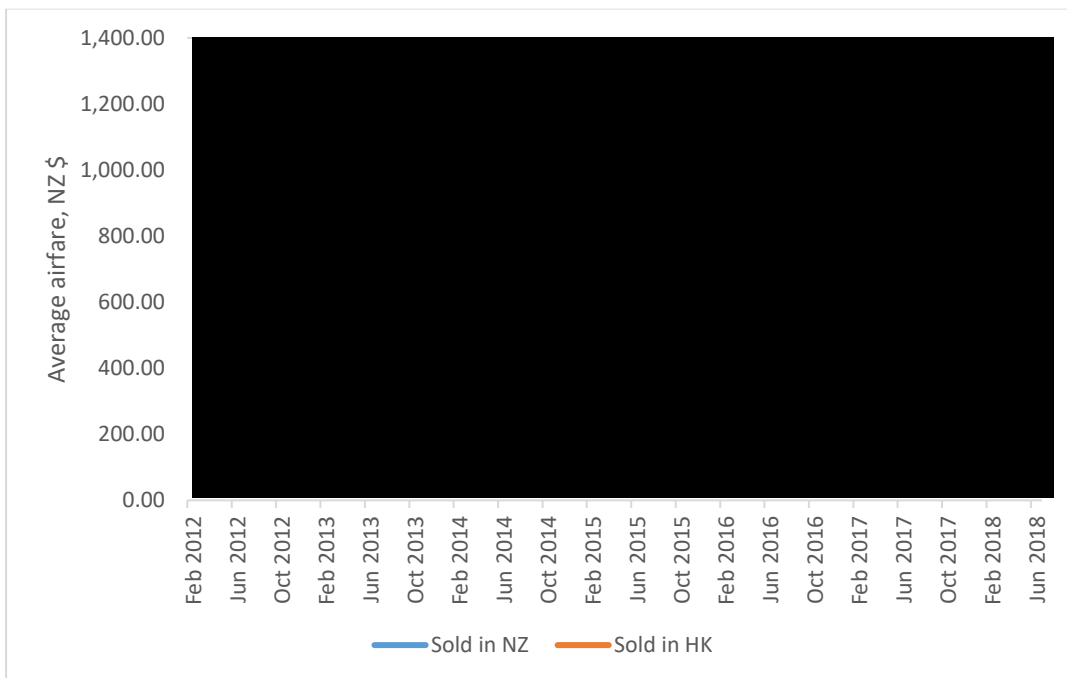
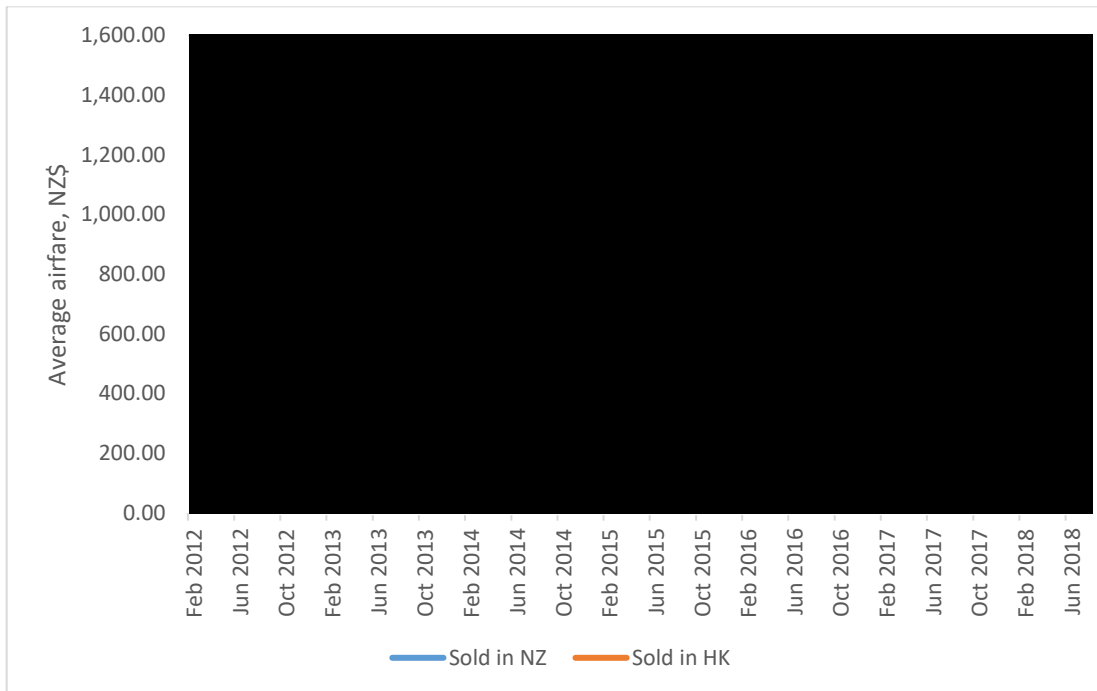


Figure 13: Cathay Pacific average airfares sold on the New Zealand – Hong Kong route (incl. Christchurch – Hong Kong from March 2018) (source: Applicants data)



175. We conducted a monthly comparison of the average airfares (for all travel classes) offered by Air New Zealand and Cathay Pacific from New Zealand and Hong Kong from 2015 to 2018, as well as the airfares by travel class over the same period. The airfares have been clearly seasonal but we concluded that average airfares as well as airfares across all travel classes sold from New Zealand and Hong Kong point of sales on direct Alliance services have fallen somewhat since 2015.

176. A range of external factors influence how airlines, including those operating alliances, set their airfares. These include fluctuations in fuel prices, levels of competition, and relative inflation and exchange rates.

- In the airline industry, an increase in the cost of jet fuel for airlines often results in an increase in the prices of tickets or cancellation of routes. The global airline industry’s fuel bill is estimated to have totalled US\$ 180 billion in 2018 (accounting for around 23.5 percent of operating expenses assuming an oil price of US\$ 72.0 per barrel). Figure 14 below shows that fuel prices were falling between 2014 and early 2016, and then rising thereafter. Alliance airfares increased during the first quarter of 2016 but have steadily decreased (considering seasonal peaks) since then. This shows that in spite of increasing operational costs, the Applicants have not increased fares on the Alliance routes.
- The level of competition also influences airfares. As stated earlier in this report, from a demand-side perspective, a significant proportion of passengers are likely to regard flights arriving in or departing from any of the airports in the Pearl River Delta region as reasonably substitutable. Therefore, airlines

operating flights between New Zealand and the Pearl River Delta region are likely to be constrained in their ability to increase airfares due to the existence of competitive offerings from airlines operating at other airports in the same region. In spite of an increasingly competitive Pearl River Delta market, the Applicants have not increased airfares during the period of reauthorisation. On the other hand, much of the recent constraint on airfares has likely come from Hong Kong Airlines, which has now exited the market.

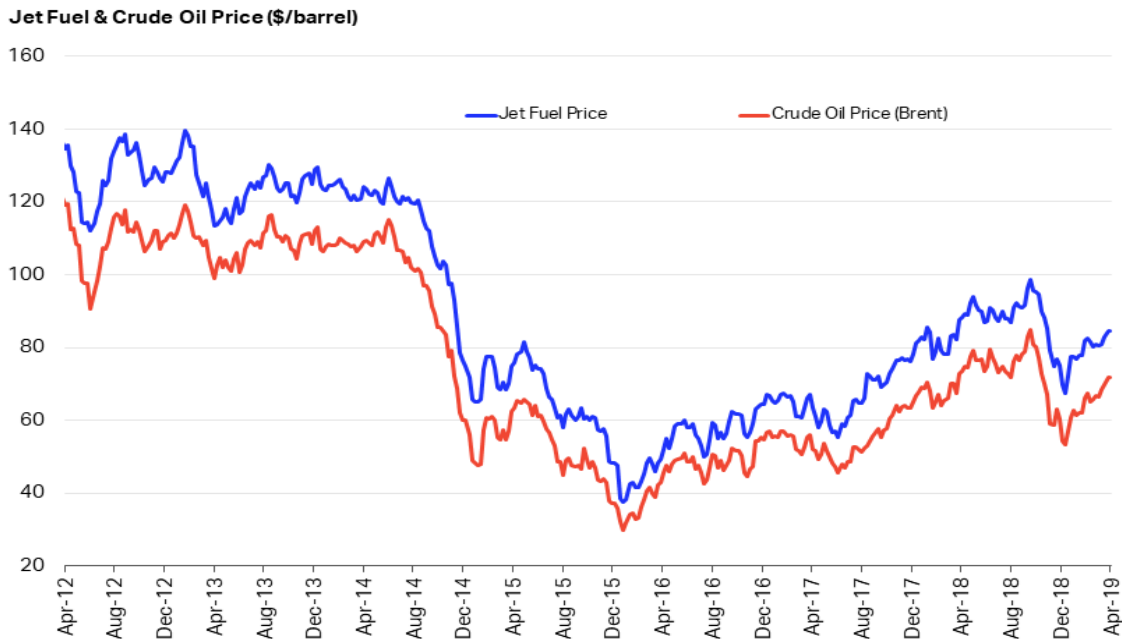
177. Overall, we conclude that this Alliance has not led to increased airfares and has responded appropriately to market conditions during the period of reauthorisation.

Increase in fuel prices

178. Fuel prices have an important impact on the profitability of the Auckland – Hong Kong route.

179. As Figure 14 shows below, since 2016, jet fuel prices have risen significantly, with a fuel price average for 2019 estimated at \$US 80 per barrel. IATA has forecasted that in 2019, fuel will cost global airlines \$US 200 billion, representing 24.2 percent of average operating costs.

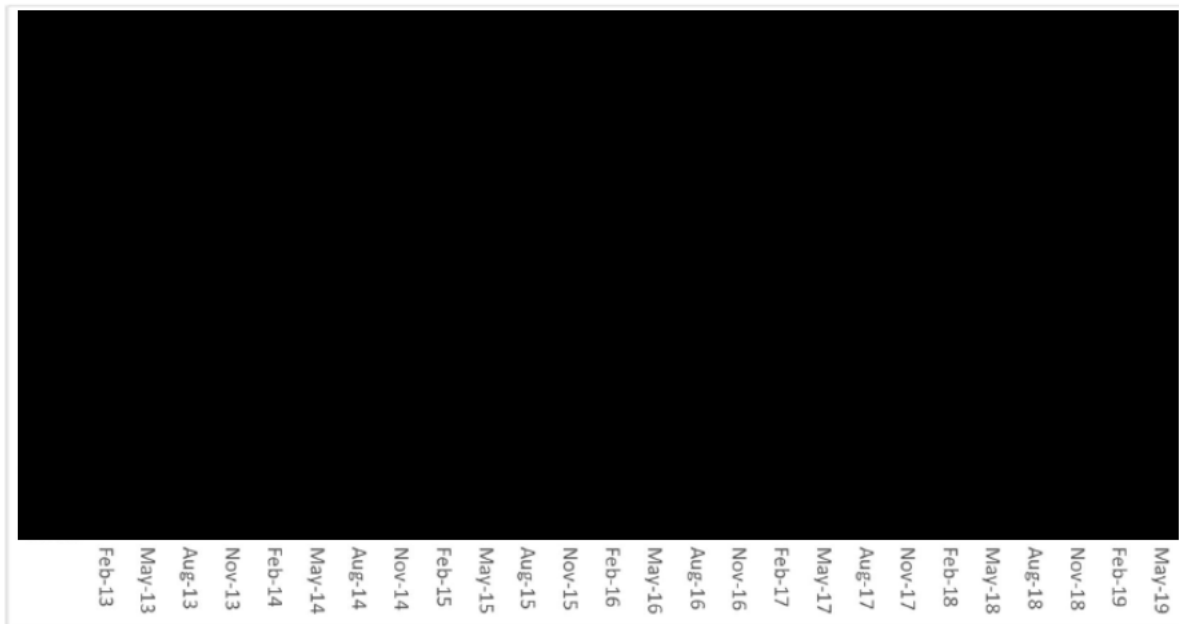
Figure 14: Jet fuel price developments – longer-term perspective (source: IATA)



Source: Platts, Datastream

180. Rising fuel prices can negatively impact on profitability, particularly if airlines cannot increase airfares without losing passengers to their competitors. Figure 15 below, shows the impact of both rising fuel costs and the inability to raise airfares, as contributing to Air New Zealand losses on the Auckland – Hong Kong route.

Figure 15: Air New Zealand – Hong Kong MAT EBIT Margin % vs Air New Zealand long haul (excl. Hong Kong) (source: Air New Zealand data)



181. [REDACTED]

The Alliance has improved connectivity to key destinations and access to new markets

Improved connecting traffic

182. Alliances facilitate greater connectivity the more complementary are the respective networks of the partners. These gains also involve improved flight schedules, more efficient use of assets, and better connection times on both sides that would not be available otherwise.

183. For Air New Zealand, connectivity through the Alliance translates into access to [REDACTED] routes (see Annex I of this report), on Cathay Pacific and Dragonair’s networks beyond Hong Kong, made available at preferential SPA rates. Since reauthorisation, [REDACTED] more routes have been added to the SPA.

184. Air New Zealand states that [REDACTED] percent of total passengers on the Air New Zealand operated services connect beyond Hong Kong. Of these passengers, [REDACTED] percent connect onto Cathay Pacific and Dragonair’s networks. More generally, Air New Zealand states that since reauthorisation, passengers connecting onto Cathay Pacific’s network beyond Hong Kong have increased by [REDACTED] percent.

185. The most popular destinations for Air New Zealand passengers connecting beyond Hong Kong were [REDACTED] in calendar year 2018.

186. For Cathay Pacific, the Alliance means access (at convenient times and competitive rates) to the Air New Zealand domestic sector beyond Auckland and Christchurch. The Applicants state that the introduction of the new route between Hong Kong and Christchurch has substantially increased the number of Alliance passengers travelling in the South Island, with over 10,000 passengers arriving from Hong Kong since introduction of the direct service.
187. The Applicants argue that opening the New Zealand domestic network to Cathay Pacific passengers has stimulated travel to regional New Zealand ports, such as Napier, Nelson, Queenstown, Palmerston North and Dunedin, and increased the number of passengers travelling to these destinations. They state that the number of passengers connecting onto Air New Zealand's network beyond Auckland (from Cathay Pacific services) has increased by 49 percent since reauthorisation.
188. In 2018, Cathay Pacific passengers coming to New Zealand on the Alliance services were mainly from [REDACTED]. As for those flying overseas from New Zealand, the most popular destinations were [REDACTED].
189. In our report on the first reauthorisation, we were sceptical about the connectivity benefits of the Alliance, in terms of access to new or poorly served markets, as it mainly focused on well-served markets such as [REDACTED], or markets being targeted by other alliances, such as [REDACTED].
190. Passengers on the Alliance services clearly use Hong Kong [REDACTED], with key cities such as [REDACTED] remaining the most popular destinations of both airlines. This is not surprising given the historically strong demand and forecasted growth in these two major markets.
191. Improving connectivity to [REDACTED].
[REDACTED].
According to Air New Zealand, approximately [REDACTED] percent of its passengers connecting [REDACTED] via Hong Kong are doing so on the Cathay Pacific network.
192. However, connecting passengers are now increasingly travelling to [REDACTED]. According to Air New Zealand, these [REDACTED] destinations constitute over [REDACTED] percent of Air New Zealand connecting traffic on Cathay Pacific's network beyond Hong Kong.
193. We also consider that the Applicants have successfully delivered on the claim that new Alliance routes could be opened between New Zealand and Hong Kong with the opening of the Christchurch – Hong Kong route on a seasonal basis. CIAL states that the second Alliance summer season saw 14 percent more New Zealanders using the service as the direct service offers a convenient way to get to Hong Kong, and improves connectivity into Asia and Europe. We consider this new route is a key benefit of the Alliance and that it improves the connectivity of the Alliance.

198. In many cases, passengers have the choice to fly with Cathay Pacific if they need to get to their destinations reasonably quickly during both seasons.

The Applicants still compete in the freight market

199. The Alliance does not provide for the Applicants to coordinate in the freight market, with cargo revenue being excluded from the definition of Alliance revenues. Therefore Air New Zealand competes with Cathay Pacific for freight between Auckland and Hong Kong.
200. Airfreight has been relatively steady since 2011 and remains a contributor to the New Zealand – Hong Kong trade market.
201. The ongoing competition between the Applicants in the freight market enabled by the Alliance could be seen as a benefit of the Alliance, if indeed [REDACTED].

Public benefits and detriments

202. The Applicants claim that the Alliance has delivered a number of benefits to the New Zealand public. We have summarised these benefits below along with our analysis of the extent to which these can be considered as real public benefits.

Increased capacity

203. As mentioned in para 160, the Secretary of Transport stated in the 2015 letter to Air New Zealand that he expected that consumer benefits of the Alliance will be manifested by an increase in capacity and passenger volumes on Alliance services across the relevant markets (principally Hong Kong and Southern China).
204. As stated earlier in the report, the Alliance has grown capacity by 11 percent (in ASKs) between New Zealand and Hong Kong since reauthorisation, mainly in seasonal summer peaks, and through the up-gauge of Cathay Pacific flights and fleet replacement.
205. The Alliance started operating a new seasonal route between Christchurch and Hong Kong on 1 December 2017 (IATA Northern Winter 2017) which has brought over 10,000 passengers from Hong Kong since the opening of the route. The Applicants confirmed that they will operate the service into Northern Winter 2019 and beyond.
206. In our 2015 report, we concluded that the likelihood of a new direct service between Christchurch and Hong Kong was relatively low. The Applicants have demonstrated that they can operate a new Alliance route to meet the demand for a direct service to Christchurch.
207. We consider this capacity increase and network growth as beneficial for New Zealand. It has increased the availability of services to and from New Zealand that was lacking from our previous report, and has provided more options for passengers.
208. The Alliance has also had a positive effect on New Zealand's international airline capacity. The Alliance has enabled the Applicants to sustain international services and to launch new ones in an economically sustainable way.

Stimulation of tourism to and throughout New Zealand

209. The Applicants claim that the Alliance has helped stimulate tourism to and throughout New Zealand by contributing to growth of visitors travelling to New Zealand from/via Hong Kong.
210. More specifically, the Applicants state that the Alliance has increased point-to-point passenger volumes by 20 percent since the last application and by ■ percent since the Alliance started operating. They have estimated that the increase in inbound passengers (tourists) travelling on the Alliance services has added a value of \$NZ 75 million to the New Zealand economy.
211. It is clear that the introduction of the new route to Christchurch has increased the number of Alliance passengers travelling to and from the South Island, with an estimated number of 10,000 passengers have arrived in Christchurch from Hong Kong since the opening of the route.
212. One of the goals of the New Zealand – Aotearoa Government Tourism Strategy is that tourism supports sustainable regions. This involves making sure that the benefits of tourism are distributed across all regions.
213. The Alliance has also generally led to more tourists travelling into regional New Zealand (through Air New Zealand's network). Cathay Pacific estimated that ■ percent of its passengers connect through Air New Zealand to ports other than Auckland, Wellington and Christchurch.
214. Many factors influence tourists in choosing New Zealand as a destination. However, the increase in total passenger volumes on Alliance services combined with the introduction of the new route suggest that the Alliance has contributed to the stimulation of tourism in New Zealand.

Lower average airfares across all travel classes

215. As per our analysis in paragraphs 170 to 177, we have not reached a firm conclusion as to whether the Alliance has consistently provided for lower average airfares across all fare classes in the markets in which the Alliance operates due to the complexity in pricing structures around booking windows.
216. However, the Alliance has not led to increased airfares and it has responded appropriately to market conditions during the period of reauthorisation.

Greater connectivity and improved flight scheduling

Connecting traffic

217. It is clear that the Alliance has facilitated greater connectivity by combining the networks of the two airlines.
218. As stated in paragraphs 183, during the period of reauthorisation, the Applicants have revised their SPA to include additional routes, with Air New Zealand having now access to ■ routes on Cathay Pacific's network, ■ more than in 2013. These changes also include lower average billing rates on both Cathay Pacific and Air New Zealand's like-for-like routes across available travel classes.

219. On the one hand, the Alliance enables Air New Zealand to leverage off Cathay Pacific's large international network, to access locations that it could not otherwise serve, including North Asia, China, and Europe on a daily basis. Air New Zealand states that passengers connecting onto Cathay Pacific's beyond network grew by [REDACTED] percent since reauthorisation.
220. On the other hand, for Cathay Pacific, the Alliance means access to Air New Zealand's domestic network. Cathay Pacific notes that the number of its passengers connecting onto Air New Zealand's domestic network grew by [REDACTED] percent since reauthorisation.
221. We consider this improved connectivity and better access to both Applicants' beyond markets as a key benefit to the Alliance that has been demonstrated by the Applicants.
222. However, as noted earlier in our report, there are still significant regulatory and geopolitical barriers preventing the connectivity benefits of the Alliance from being fully realised through a more formal codeshare arrangement between the Applicants (whereas currently the cooperation is limited to interlining). [REDACTED]
[REDACTED]
[REDACTED]

Optimisation of flight scheduling

223. The Applicants have made changes to their respective schedules to provide their customers with a better choice of flight times, including the ability to purchase cross-metal tickets (i.e. where one carrier sells tickets onto the other carrier's Auckland/Christchurch - Hong Kong services) with more seamless connections.
224. As stated in our previous report, we accept the Applicants' claim that cross-metal sales provide consumer benefits, especially to time-sensitive passengers and loyalty programme members. However, we consider that those benefits remain small since many customers travel for leisure and price rather than having departure time during the day as a primary consideration.
225. Air New Zealand has brought forward the departure time of its flight NZ080 service from Hong Kong from 1910 to 1810 for the Northern Summer IATA season. The Applicants argue this was to have a bigger gap between their respective services (with Cathay Pacific's service departing Auckland at 2105pm), to reduce the time that aircraft spent grounded at Hong Kong International airport.

Joint lounge access and premium customers' benefits

226. Air New Zealand argues that the Alliance passengers continue to get substantial increases in Airpoints accruals and in the award of Airpoints dollars. More specifically, there was a rise of nearly [REDACTED] actual Airpoints accruals during the 2017-2018 period, and approximately [REDACTED] Airpoint Dollars were awarded to Air New Zealand passengers travelling on the Alliance services over the same period.
227. The Applicants also note that the Alliance provides for reciprocal lounge access on the Auckland – Hong Kong and Christchurch – Hong Kong routes. The number of Cathay Pacific premium customers using Air New Zealand's lounge in Auckland has not changed (approximately [REDACTED] per month) whereas the number of Air New Zealand passengers using Cathay Pacific's lounge in Hong Kong has increased slightly since

reauthorisation (from ■ to ■ passengers per month). The Applicants estimate the number of Cathay Pacific's passengers using the Air New Zealand lounge in Christchurch has been estimated at approximately ■ passengers over the Northern Winter 2017 season.

228. The Ministry accepts that the Alliance provides additional benefits to consumers with respect to loyalty programs and lounge access. However, these benefits remain modest and limited to a subset of premium and/or frequent customers.

Terms of authorisation

229. The Applicants request reauthorisation of the Alliance until 31 October 2024, i.e. for a further term of five years.
230. We consider that a five-year term provides a sufficient level of certainty and stability to the Applicants to make long-term investment decisions, and allows for the reassessment of the Alliance at an appropriate interval.

Conclusion

231. In consideration of the above analysis and the counterfactual scenario, we believe that the Alliance delivers benefits to New Zealand that outweigh the potential detriments.
232. The Alliance still meets the statutory conditions allowing it to be authorised under section 88 of the Civil Aviation Act 1990.
233. On that basis, we recommend that the Alliance be reauthorised for a period of five years, ending 31 October 2024.

	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]
	[REDACTED]	[REDACTED]