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Mr Bruce Johnson
General Manager Aviation & Maritime
Ministry of Transport
89 The Terrace
Wellington

Dear Bruce

Preliminary views on application for authorisation of a North Asia Alliance between Air New Zealand and Cathay Pacific Airways

Introduction

Auckland Airport appreciates the opportunity to respond to and comment on the application for authorisation of a North Asia Alliance Agreement between Air New Zealand and Cathay Pacific.

Air New Zealand and Cathay Pacific have applied to the Ministry of Transport for authorisation, pursuant to s88 of the Civil Aviation Act, of alliance and code-share arrangements they propose entering into on the Auckland – Hong Kong route.

Air New Zealand has briefed our organisation separately on this proposal. Cathay Pacific has not been in touch with Auckland Airport in relation to this application.

We understand the Ministry's analysis will be looking at both the proposals' compliance with the specific provisions in s.88(3)-(5) of the Civil Aviation Act 1990 and the overall public interest.

The Ministry has invited our preliminary views on the impact that the Alliance, if approved, would have on the services offered between New Zealand and Hong Kong and to and from third countries (including China and points in Europe) via Hong Kong.

Summary

We are committed to ensuring that the New Zealand travel market remains competitive, accessible, and viable for consumers and stakeholders, and with sufficient capacity to deliver essential travel and trade growth to support New Zealand's economic interests.

Auckland Airport is not, in principle, opposed to an alliance of airlines where the alliances can demonstrably improve or retain consumer, supplier and economic benefits that would otherwise exist in the natural competitive market and do not provide unnatural market power that affects the sustainability of markets and competitors.

Auckland Airport remains open to potential alliance outcomes that deliver genuine benefit to consumers and value to aviation stakeholders. However, based on the limited information that has been provided, we are not in a position to allay concerns that this proposed alliance may have the potential to negatively impact on air-service capacity and air-service competition between New Zealand and Hong Kong, and between Hong Kong and key onward market connections, particularly mainland China and Europe.

We would emphasise here that Hong Kong, its connections to mainland China and Europe, are key air-service routes and tourism and trade markets for New Zealand. Around 17% of the annual traffic between New Zealand and Asia, and 17% of the annual traffic between New Zealand and Europe, comes through Hong Kong.

We estimate that China Southern currently accounts for about 30% of the total China/Pearl River Delta to New Zealand traffic. This proposal therefore will clearly give the other two players a sole market position on Hong Kong as well as an ability to potentially dominate mainland Pearl River Delta China and onward to Europe routes.

As we do not have access to the full submission, provisions or insight from the airlines on their commercial positions in relation to this proposed alliance, we do not believe any party with the same limited access to information as ourselves has sufficient understanding to arrive at a firm view on the merits or the potential impact, if approved, of the airline proposal.

Consequently, we have sought some analysis of the proposal (a review by CAPA is enclosed), which has provided us with a number of questions and analysis that we hope will be helpful for the considerations of the Minister and other interested parties. We would welcome the opportunity to work through these questions and this analysis with the airlines and with the Minister.

Benefit Commitment and Market Power

We understand from Air New Zealand and MOT that the alliance proposal includes pricing, schedule and capacity co-ordination similar to those operating under the Trans-Tasman Virgin Australia Alliance, an alliance still in its early stages.

Cathay Pacific and Air New Zealand are the sole operators on the HKG-AKL market and this alliance provides a significantly greater degree of market power when compared with the Trans-Tasman Virgin Alliance where other carriers provided significant direct capacity/frequency share competitive tension.

From the limited information provided, our own assessment and from the expert analysis we sought, we have formed the following preliminary views of the alliance proposal.

Joint service agreements – can deliver benefits but can also inhibit competition, and we don't have enough information to make a determination on this proposal

We believe that connections and code shares can provide genuine benefits to customers by improving connectivity and convenience. The benefits can be delivered by seat share/code share agreements that do not reduce competitive environments extensively. However in this case we remain unclear as to the true cost and benefit structure that would arise from co-ordination of capacity, schedule and pricing so remain concerned that the potential benefit may be eroded.

We note that Qantas has never code shared with its Oneworld partner Cathay Pacific on the Australia-Hong Kong route (only on limited routes beyond Hong Kong to Europe). We understand that the competition regulators have made it clear that such an arrangement would not be acceptable on a sector where both carriers compete (often aggressively).

Market definition – we remain unconvinced that mainland China can or should be aggregated with Hong Kong

The market definition appears to have been narrowed to HKG-AKL when considering negatively affected existing customers but widened to connecting markets particularly China/Europe/Asia when considering benefits and competitive pressure. The market definition therefore raises questions as to consideration of capacity/frequency share, market power and genuine added benefit. For example we need to consider if Guangzhou is a factor in influencing the Hong Kong market, then is the Air New Zealand and Virgin code-share arrangement across Shanghai also to be considered. Estimates suggest that China Southern share of the total Pearl River Delta market to New Zealand is relatively small.

Trends in the Hong Kong market indicate that traffic has been declining since 2008 (well before the introduction of China Southern from Guangzhou) and has followed declining seat capacity. That said load factors appear to have been maintained at similar rates since 2008.

We believe that a number of factors, such as the GFC, growth in direct services from mainland China to Australia, fleet replacement, and yield management practices are likely to be more relevant to a decline in capacity on the market than the introduction of China Southern.

We also remain unconvinced by the extent of market substitution that would arise from the choice between flying to New Zealand from Guangzhou or from Hong Kong, given the different hub and market characteristics of the two points.

Lack of guarantees and commitments is a market risk

The lack of guarantees or specific undertakings outlined in the areas of inbound tourism stimulation, capacity maintenance/growth and seats inventory/fare allocations suggest that little to no value can be attributed as they would appear to be market driven. If these benefits are largely market driven then the reduction of competitive structures does suggest the opposite outcomes could also be a market outcome i.e. jointly reduced capacity, joint management to higher fares at lower demand to build airline value rather than customer value and economic value. This has been the experience on some long haul New Zealand routes where competition has been reduced, and based on the analysis we must remain uncertain on this proposal.

Potential growth impediments

The airlines also suggest in the proposal that there are carriers poised to enter the HKG-AKL market such as Hong Kong Airlines. Given the very fast structural changes that can impact the industry and carrier mix and the market power that would exist under the proposed alliance we believe it would reduce the attractiveness of the route to competitors and may actually reduce the future sustainable air capacity unless capacity guarantees were given.

We cite the example of the Qantas-South Africa arrangement, where there had been an increase in capacity and service levels over the course of the code share. However, the only competition to emerge on the route was Virgin's V Australia which eventually withdrew as it found the service to be uneconomic.

Yours sincerely,

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