

**Application to the Minister of Transport pursuant to Part 9 of the Civil Aviation Act 1990 for authorisation of the Air New Zealand and Cathay Pacific Airways North Asia Alliance**

**[information confidential to Air NZ]**

**[information confidential to the Applicants (to be redacted from public version of application)]**

### Confidential Information

Air New Zealand Limited (**Air NZ**) and Cathay Pacific Airways Limited (**Cathay Pacific**) (together, the **Applicants**) claim confidentiality for this Application pursuant to section 9(2)(b) of the Official Information Act 1982.

A Public Version will be provided separately, and information redacted in the Public Version in this Confidential Version is enclosed in square brackets and highlighted blue (being information which is confidential to the Applicants) or yellow (being information which is confidential to Air NZ) (the **Confidential Information**).

The Confidential Information is commercially sensitive and valuable information which is confidential to the Applicants (*vis-a-vis* the public and also in some respects *vis-a-vis* each other), and disclosure would be likely to unreasonably prejudice the commercial position of one, or both, of the Applicants.

The Applicants request they be notified of any request made under the Official Information Act for release of the Confidential Information, and that the Minister of Transport (the **Minister**) seeks their views as to whether the Confidential Information remains confidential and commercially sensitive at the time responses to such requests are being considered.

This request for confidentiality is not intended to constrain the Minister and the Ministry of Transport (the **Ministry**) from disclosing information to other Government departments for the purpose of seeking relevant expert advice. However, the Applicants request that the Minister ensure any such departments maintain the same full confidentiality as requested above.

## 1. EXECUTIVE SUMMARY

### The Alliance

- 1.1 On 18 October 2012 the Minister granted Air NZ and Cathay Pacific authorisation pursuant to section 88 of the Civil Aviation Act 1990 (the **CAA**) to make and give effect to the North Asia Alliance Agreement (**NAAA**), the Code Share Agreement and related agreements contemplated in the NAAA (together, the **Alliance**).
- 1.2 Copies of the executed NAAA (as amended) and Code Share Agreement are set out in Schedule A.
- 1.3 As part of the authorisation of the Alliance by the Minister, the Applicants agreed to include a term in the NAAA to the effect that the Applicants would cease to give effect to the NAAA unless they have first received reauthorisation of the Alliance from the Minister by the third anniversary of the Revenue Sharing Start Date (being 30 January 2013).
- 1.4 The Applicants are seeking authorisation from the Minister under section 88 of the Act to give effect to the Alliance for a further period of five years from 30 January 2016. We attach (as Schedule B), a signed copy of an amendment to the NAAA providing for Alliance to continue until 30 January 2021, whereby a further authorisation will be required.

### Scope of cooperation

- 1.5 The NAAA provides for varying levels of coordination between the parties in relation to:
  - (a) **Alliance Routes**, being sectors operated by either airline between New Zealand and Hong Kong (i.e. currently Auckland – Hong Kong); and
  - (b) **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.
- 1.6 The Alliance provides for broad scheduling, pricing and capacity coordination on both the Alliance Routes and the Feeder Routes. The Alliance also provides for a free-sell codeshare and revenue allocation on the Alliance Routes only.
- 1.7 The Alliance is supported by a number of “Implementing Agreements”. These include a Special Prorate Agreement (**SPA**) which provided new and more favourable rates on connecting flights to certain “beyond” destinations within the Applicant’s respective networks.

### Public benefits

- 1.8 Despite the short time within which the Alliance has been in existence, it has already exhibited a range of public benefits:
  - (a) the ability to sell on each other’s Auckland – Hong Kong service has allowed each airline to offer a better choice of flights times for return journeys, the amount of cross metal sales illustrating the value customers place on this choice;
  - (b) each airline’s online connectivity and product offering has increased. The Alliance provides both the ability and incentive for each Applicant to offer a greater range of destinations to customers at better prices. Since the Alliance commenced, there has been a significant increase in the volume of customers connecting between the Applicants’ services. These customers pay lower fares on connecting services due to the revised SPA, and experience an enhanced

product offered due to the reciprocal customer benefits, and the ability to earn and redeem frequent flyer points on each airline's services;

- (c) the Applicants have sought to maximise efficiencies through working together to revenue manage the Auckland – Hong Kong route. They have also worked together to market New Zealand as a tourist destination for visitors from Hong Kong, with Hong Kong tourism increasing by around 13% since the commencement of the Alliance;
- (d) the Applicants have continued to compete for air freight, which continues to be an important element of New Zealand – Hong Kong trade; and
- (e) the Alliance has allowed Air NZ to maintain its presence in a key Asian market, with interline access to strategically important North Asian destinations.

### No consumer detriment

- 1.9 As set out in the Ministry's 2012 report to the Minister on the Alliance (**MOT Determination**), in the absence of the Alliance one of the parties would withdraw from the Auckland – Hong Kong route. To the extent that this remains the case, competition will not be adversely affected by the Alliance, and the Alliance increases competition on routes beyond Auckland – Hong Kong.
- 1.10 Even if the Ministry does consider that both of the Applicants would continue to compete on the Auckland – Hong Kong route in the absence of the Alliance, the Applicants will continue to be constrained by a number of established one-stop carriers. These carriers have increased their market share since the Alliance commenced, for all categories of passenger. Fares on this route have remained at competitive levels since the commencement of the Alliance.

## 2. Background

### 2012 authorisation

- 2.1 As the Ministry will be aware, the Applicants entered into the NAAA on 20 April 2012, and commenced revenue sharing on the Alliance Routes on 31 January 2013. The Alliance received regulatory approval from the Minister for a three year period, which will expire on 30 January 2016.
- 2.2 The current flight schedule is set out in Table 1 below.

**Table 1: Alliance flight schedule for Northern Winter 2014/5<sup>1</sup>**

Flight No	Days of operation	Flight departs	Flight arrives	Flight duration
Auckland to Hong Kong				
CX198 (NZ4995)	MTWTFSS	1430	2100	11h30m
NZ087 (CX7402)	MTWTFSS	2350	0605 <sup>+1</sup>	11h15m
CX118 (NZ4995)	MTWTFSS (from 02/1/14 to 15/03/15 only)	0900	1525	11h25m
Hong Kong to Auckland				

<sup>1</sup> CX117 and CX118 are the additional services that operate over the peak Northern Winter periods (not during Northern Summer), and NZ0800 will return to a 1920 departure.

CX117 (NZ4992)	MTWTFSS (from 01/12/14 to 14/03/15 only)	1525	0735 <sup>+1</sup>	11h10m
NZ080 (CX7401)	MTWTFSS	1750	0950	11h
CX197 (NZ4994)	MTWTFSS	2100	1305 <sup>+1</sup>	11h05m

2.3 Operational changes since the Alliance commenced include:

- (a) a shift of Air NZ's NZ080 service from a departure time of 1920 to the current 1750 departure, commencing Northern Winter 2014/5. This will revert back to a 1910 departure for Northern Summer 2015.
- (b) Cathay Pacific introducing a premium economy cabin into the aircraft that it operates on the Alliance Route (starting October 2013), thereby making its product offering on the route more aligned with Air NZ's (by having a 3-cabin configuration instead of 2 cabins). Customers who enjoy the premium economy cabin are able to travel in it on either carrier, and both carriers can now sell into each other's premium economy cabin on the Alliance Route.
- (c) Cathay Pacific has extended its CX117/8 service by two weeks in the Northern Winter 2014/5 season due to growth in demand for the service over the peak period. Depending on the level of bookings for the extended service, it is expected that extension will occur in subsequent Winter seasons.

**Alliance performance and market conditions**

- 2.4 As set out in the MOT Determination, prior to the Alliance both of the Applicants had found the Auckland – Hong Kong route to be a challenging one, due in part to the significant decline in visitor arrivals from Europe, as well as increasing fuel prices and challenging economic conditions generally. This saw total passenger numbers on services between Hong Kong and Auckland decline in the years prior to the Alliance. These challenges were also going to increase for Air NZ upon Air NZ's suspension of its Hong Kong – London services in March 2013. Prior to the suspension of its Hong Kong – London services, [ ]% of passengers that Air NZ carried on Auckland – Hong Kong travelled through to London.
- 2.5 Air NZ announced the suspension of its Hong Kong – London service in November 2012. In order to minimise the impact from the suspension of this service, the Applicants agreed an approach to retain as much of the New Zealand – London traffic as possible and seek to replace any lost traffic with a different traffic mix.
- 2.6 Despite the immediate challenges, during the first year of the Alliance the parties were, together, able to maintain passenger numbers and load factors on the Auckland – Hong Kong service. As set out in Table 2, in its first year of operation revenue on the alliance route has increased by [ ]%, with a [ ]% increase in load factors.

**Table 2: Passenger numbers and revenue pre and post alliance for HKG – AKL sector (all destinations)**

	Pre-alliance (31 Jan 2012 – 30 Jan 2013)	Post alliance 1 (31 Jan 2013 –30 Jan 2014)	Last six months (31 Jan 2014 – 30 July 2014)
Revenue (US\$000s)	[ ] %	[ ] %	[ ] %
Passenger numbers	[ ] %	[ ] %	[ ] %
Load factor	[ ] %	[ ] %	[ ] %

- 2.7 As discussed further below, the Applicants were able to vary the traffic mix on the route and replace passengers that may have otherwise travelled on Air NZ's Hong Kong – London services such that overall New Zealand – Hong Kong services have been maintained notwithstanding Air NZ's withdrawal from Hong Kong - London.
- 2.8 The Applicants have been able to achieve this by having access to a greater range of services connecting into each other's networks, and by being incentivised to sell into each other's services on a metal neutral basis. For Air NZ in particular, the suspension of its Hong Kong – London services has meant that Air NZ has sought to maintain similar load factors on its Auckland – Hong Kong services by replacing some of that traffic. Key to this has been the additional access each Applicant has had to the other's network connections, which neither would have absent the Alliance. In the year ended September 2014, over 75,000 passengers connected from an Air NZ operated flight onto a Cathay Pacific or Dragonair service,<sup>2</sup> or vice versa. As set out in section 4 below, this is a significant increase since the commencement of the Alliance.
- 2.9 The Alliance does not currently include the ability for Air NZ to codeshare onto Cathay Pacific's China services. [REDACTED].]
- 2.10 Accessing China through Hong Kong (currently on an interline basis) remains extremely important to Air NZ and Cathay Pacific, and this has not changed following the announcement that Air NZ has signed a statement of intent to work with Air China regarding a potential alliance. The Alliance has allowed Air NZ to grow Auckland – Hong Kong as an effective second gateway to and from mainland China, despite the lack of any codeshare arrangement with Cathay Pacific. It has separately allowed Cathay Pacific to use Air NZ's Auckland – Hong Kong service to offer better connectivity with its own services into China. The statement of intent with Air China is non-binding, and any cooperation between Air NZ and Air China faces a number of hurdles. During that time, and in parallel with any subsequent Air China arrangement, the Alliance will continue to provide important connectivity between New Zealand and points in China, Western China, Taiwan and South Korea, as well as Hong Kong.
- 2.11 The Auckland – Hong Kong route remains a challenging one. The Alliance continues to face strong competition, both for services to Hong Kong and the wider Pearl Delta region, and for services beyond Hong Kong. In particular, since the Alliance commenced, China Southern Airlines has increased the number of flights and capacity on its Guangzhou to Auckland services so that it now operates a double daily service. Christchurch Airport have also recently announced a partnership with Chinese travel agent GZL, which will see three charter flights operated directly to Christchurch in February 2015.<sup>3</sup> Other one stop carriers have also increased capacity on services into either New Zealand or Hong Kong. Notwithstanding this, the first year of the Alliance has provided a stable platform for the Applicants to work on improving traffic flows on their Auckland – Hong Kong services, thereby improving their long-term sustainability. From here the Applicants hope to continue to improve overall performance of the route and to explore options for increasing services.

### Counterfactual

- 2.12 In the MOT Determination, the Ministry stated that in the absence of the Alliance:<sup>4</sup>

....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

<sup>2</sup> Dragonair is a regional subsidiary of Cathay Pacific, with a hub in Hong Kong, operating to 44 destinations in 13 countries across Asia. For simplicity, references in this application to Cathay Pacific services beyond/beyond Hong Kong or to Cathay Pacific's network, include Dragonair services out of Hong Kong.

<sup>3</sup>[http://www.christchurchairport.co.nz/media/729436/government\\_support\\_for\\_airport\\_s\\_welcome\\_china\\_project.pdf](http://www.christchurchairport.co.nz/media/729436/government_support_for_airport_s_welcome_china_project.pdf).

<sup>4</sup> MOT Determination, paragraph 17.

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.

The Ministry concluded that in the absence of the Alliance it was “almost inevitable” that one of the two carriers would exit the route.<sup>5</sup>

- 2.13 The Applicants have provided the Ministry with separate confidential submissions on the likely outcomes to their own business if the Alliance was not to continue beyond 30 January 2016. However, for the purposes of the analysis below, we have used the Ministry’s counterfactual from the MOT Determination as a basis for our assessment of public benefits and detriment i.e. a reduction in services and the exit of one of the parties from the Auckland – Hong Kong route.
- 2.14 Based on such a counterfactual, the Alliance will have no impact on the number of competing carriers on the Auckland – Hong Kong route. As explained further below, the absence of the Alliance would also have an impact on routes beyond Hong Kong.

### 3. The Authorisation Sought

- 3.1 The Minister’s discretion to authorise the Alliance is provided for in section 88(2) of the Act. The Applicants believe the Alliance meets the test for authorisation and the Minister should exercise his discretion to reauthorise the Alliance pursuant to section 88 of the Act, whereby the Applicants will cease to give effect to the Alliance after five years from 31 January 2016 unless it is re-authorised.
- 3.2 The Applicants have sought a five year period for the reauthorisation in order to provide the Applicants with the opportunity to take steps to strengthen performance on the Auckland – Hong Kong route and to provide the Applicants with a level of certainty and confidence to implement additional projects that will drive benefits from the Alliance. It is also consistent with the term of the Air NZ/Virgin Australia reauthorisation application and that granted to Qantas/Emirates.
- 3.3 The sections below outline why the Minister should exercise his discretion to approve the Alliance, and in particular why the NAAA and its Implementing Agreements give rise to a range of benefits to the travelling public and the New Zealand public generally that outweigh any potential detriment.

### 4. Public benefits derived from the Alliance

- 4.1 In the MOT Determination, the Ministry found that the Alliance would result in a range of public benefits, including a continued Air NZ presence in a key Asian hub, continuation of competition between the parties in the freight market, and the opportunity for the Applicants to draw on each other’s network in order to provide improved itineraries for the travelling public.<sup>6</sup> The Ministry also found that some consumers would benefit from reciprocal frequent flyer benefits and joint lounge access.<sup>7</sup>
- 4.2 Despite the short time within which the Alliance has been in existence, it has already generated considerable public benefits, and is well placed to deliver more if reauthorised. We comment below on the benefits analysed in the MOT Determination, and how the Alliance is achieving these benefits.

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<sup>5</sup> MOT Determination, paragraph 26.

<sup>6</sup> MOT Determination, paragraphs 18 - 20.

<sup>7</sup> MOT Determination, paragraph 21.

### Improved time of day benefits

- 4.3 In the MOT Determination, the Ministry found that there was little scope to improve flight schedules under the Alliance, given that the parties did not currently operate 'wingtip to wingtip'.<sup>8</sup> As set out in the application for authorisation of the Alliance in 2012 (the **2012 Application**), the Applicants operated flights at different times of the day prior to the Alliance, and have largely maintained this schedule since. This has been improved recently with the change in flight time for the NZ080 service from a departure time of around 1920 to the current 1750 departure. This gives customers a better choice of flights times for the Northern Winter season, without affecting the number of connecting services available to these passengers.
- 4.4 The ability for passengers to choose between different services, depending on their reason for travel, end destination and other travel preferences, has been a significant benefit of the Alliance. The reason for this is that customers can now choose between the flights of both Applicants as part of a larger journey. For example:
- (a) outbound from New Zealand, Cathay Pacific passengers can now take advantage of Air NZ's service arriving early morning Hong Kong time to connect to Cathay Pacific's early morning services to other Asia destinations;
  - (b) business travellers are now able to travel overnight from New Zealand to Hong Kong on an Air NZ operated service, have a full working day in Hong Kong, and travel back to New Zealand on Cathay Pacific's late night service; and
  - (c) Cathay Pacific is now able to connect its large number of flights arriving into Hong Kong during the early afternoon onto Air NZ's evening Hong Kong – Auckland service.
- 4.5 The level of cross metal sales since commencement of the Alliance, where one carrier has sold a ticket onto the other carrier's Auckland – Hong Kong or vv services, demonstrates the value customers place on the ability to choose between the multiple time of day offerings that each carrier can now offer to customers.
- 4.6 The level of cross metal sales is illustrated in Figure 1.

**Figure 1: Cross metal sales on Auckland – Hong Kong vv**

Source: Applicants' data

- 4.7 As the cross metal sales figures illustrate, customers clearly value the choice in travel time provided by the Alliance, particularly where travel preferences are best met by travelling on one carrier on the outward leg, and another on the return. While the Applicants do not compile data on the number of passengers who use one airline on one leg, and the other airline on the return journey, the Applicants estimate that up to [ ] % of total passengers travel in this manner. This is a further specific benefit for passengers that arises from the Alliance.

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<sup>8</sup> MOT Determination, paragraph 91.

- 4.8 While the MOT observed in the MOT Determination that, prior to the Alliance, passengers already had the ability to choose between the services offered by both airlines, the extent of cross metal sales shows that customers value and perceive a benefit from the ability to purchase tickets on any of the Alliance services from either Applicant. The principles and obligations regarding metal neutrality in the Alliance also create incentives for each Applicant to fully utilise the flexibility provided by access to each other's services, and thereby offer the best outcome for the customer.
- 4.9 Prior to the Alliance Air NZ's primary incentive was to connect passengers onto its Hong Kong – London service or to drive point to point traffic on its own service. Equally, Cathay Pacific had little incentive to drive traffic onto Air NZ's Auckland – Hong Kong service even though its customers may have preferred this service for their travel requirements. This was reinforced by the lack of any FFP reciprocity as between the parties. Neither party had an incentive to provide travel that involved travelling in one direction on one carrier and the other on the return journey. However, now that the Applicants are indifferent as to which carrier a passenger chooses for travel between Auckland and Hong Kong, they each have an incentive to promote various cross metal options, such as those described in paragraph 4.4 above. Every customer that utilises the ability to travel on a cross metal basis, who did not prior to the Alliance, is obtaining a benefit from doing so.

#### **Additional interline connections**

- 4.10 In the 2012 Application, the Applicants submitted that the Alliance would enable more on-line connections to points served by Cathay Pacific beyond Hong Kong (due to access to flights at very different times of the day, thus connecting to different beyond flights) and to points served by Air NZ in domestic New Zealand and the Tasman. This would arise from each Applicant having the incentive to market services on an additional flight each day to/from which connections can be made (for the reasons described in 4.8 and 4.9 above). The Ministry found that the benefits for consumers were not clear, as passengers already had access to connecting flights, by booking a ticket with Cathay Pacific (when travelling beyond Hong Kong) or with Air NZ (when travelling beyond Auckland to other points in New Zealand or Australia).
- 4.11 A number of features of the Alliance have acted to increase connectivity. First, each airline now has access to an increased choice of departure times, providing its customers with a greater awareness of, and opportunity for, online connections beyond Hong Kong and beyond Auckland. Secondly, the Alliance creates an incentive for each party to provide the other with access to its network beyond Hong Kong (for Cathay Pacific) and Auckland (for Air NZ). The reason for this is that both Applicants benefit under the Alliance from any increase in travel on the Auckland – Hong Kong services.
- 4.12 The increased connectivity is illustrated by Air NZ's Auckland – Hong Kong service. This arrives at 6.05am, which provides Cathay Pacific passengers with the option to connect onto Cathay Pacific's morning services into other parts of Asia (China in particular). Prior to the Alliance, Cathay Pacific would have no incentive to provide customers with an option to purchase this itinerary, and even if a passenger knew that this itinerary was available, they may have had to book two separate tickets with two separate airlines, losing the convenience and connectivity benefits one booking would provide.
- 4.13 While the Ministry is correct that these flight options were available to customers prior to the Alliance, the level of passengers connecting from Air NZ to Cathay Pacific services (and vice versa) illustrates the benefits passengers perceive from increased online connectivity.
- 4.14 The number of passengers connecting from Air NZ services onto the Cathay Pacific network has increased by [redacted]% since the commencement of the Alliance, with [redacted]%

of passengers carried by Air NZ connecting to or from the Cathay Pacific network. While some of this rise will be a consequence of Air NZ reaccommodating passengers from its suspended Hong Kong – London route, there have also been a substantial number of Air NZ passengers connecting onto Cathay Pacific's China services.

- 4.15 Figure 2 shows those parts of the Cathay network that Air NZ passengers are connecting onto. As the Figure shows, Air NZ passengers connecting onto Cathay Pacific's London service has dropped significantly since the initial spike caused by reaccommodation, largely replaced by an increase in travellers connecting to or from China.

**Figure 2: Air NZ passengers connecting onto the Cathay Pacific network (MAT)**

- 4.16 Figure 3 shows the rise in passengers connecting onto the Air NZ domestic network. Passengers connecting onto the Air NZ network have increased by [ ]% (on an MAT basis) since the commencement of the alliance. The greater increase since February 2014 is a result of Air NZ making changes to its ticketing time limits to better facilitate Cathay Pacific selling itineraries that include a domestic New Zealand sector, a benefit that Air NZ would not offer to Cathay Pacific absent the Alliance.

**Figure 3: Cathay Pacific passengers connecting on the Air NZ network (MAT)**

**Lower fares for connecting passengers**

- 4.17 The revised SPA reflects the increased incentive of each Applicant to provide the other with better access to its network. As set out in the 2012 Application, the Alliance provided for the Applicants to enter into a reviewed SPA to replace the existing SPA

between them. Given the lack of incentive for each Applicant to provide competitive access (exacerbated by the fact that each Applicant belonged to different alliances) the former SPA agreement was relatively limited, both in terms of the destinations covered and access to the various booking classes. Due to the incentives created by the Alliance, the revised SPA expanded both the number of routes available and the booking classes available.

4.18 Table 3 summarises the main differences between the pre-Alliance SPA and the revised SPA. It shows that:

- (a) the number of new routes available to Air NZ on Cathay’s network has doubled for economy classes, and more than quadrupled for business class;
- (b) the number of routes available to Cathay Pacific on Air NZ’s network has also almost doubled;
- (c) average billing on like for like tickets has decreased on all routes; and
- (d) booking class access has also at least doubled in economy, and increased in business.

**Table 3: comparison of SPA pre and post Alliance**

		Class	Pre-alliance	Post-alliance	Variance
CX network	Number of routes in SPA	Economy	[ ]	[ ]	[ ]
		Prem Economy	[ ]	[ ]	[ ]
		Business	[ ]	[ ]	[ ]
		Total	[ ]	[ ]	[ ]
	SPA rates on like for like routes	Economy	[ ]	[ ]	[ ]
		Prem Economy	[ ]	[ ]	[ ]
		Business	[ ]	[ ]	[ ]
NZ network	Number of routes on SPA	Economy	[ ]	[ ]	[ ]
		Premium <sup>9</sup> Economy	[ ]	[ ]	[ ]
		Business <sup>9</sup>	[ ]	[ ]	[ ]
		Total	[ ]	[ ]	[ ]
	SPA rates on like for like routes	Economy	[ ]	[ ]	[ ]
		PPE	[ ]	[ ]	[ ]
		Business	[ ]	[ ]	[ ]

4.19 As part of its confidential submission, each Applicant has provided the Ministry with information on how the benefits of the new SPA have been passed through to its respective customer base. As the Applicants continue to compete with each other for connecting traffic, this information is confidential between them. However, consistent with the significant increase in connecting passengers onto each Applicant’s network, the benefits of the SPA are being passed onto customers.

<sup>9</sup> [ ]

## Efficiencies

- 4.20 In the 2012 Application the Applicants claimed that cost savings would arise from the Alliance through a mixture of more efficient use of the parties' aircraft (increased load factors), shared airport lounge facilities and shared ground handling.
- 4.21 The Alliance governing arrangements provide for the establishment of a Commercial Board, made up of representatives of each Applicant, to oversee revenue management of the Auckland – Hong Kong route. By working together, and combining data on forecasts of likely demand and forward bookings, the Applicants are better able to forecast demand for a given flight and act early to stimulate demand.
- 4.22 This has allowed the Applicants to better utilise capacity on their Auckland – Hong Kong service. Evidence of the improvements created by joint revenue management are set out in Table 1 above, the parties have managed to increase load factors by [ ]% in the first year of the Alliance, and by a further [ ]% in the six months to 31 July 2014.
- 4.23 Following commencement of the Alliance, each of Air NZ and Cathay Pacific went through a tender process for their respective ground handling in Hong Kong and New Zealand respectively. In both cases, the relevant Applicant provided offers to supply the ground handling services but were unable to win them from the incumbent providers. [ ]

## FFP and lounge benefits

### *FFP accrual and redemption*

- 4.24 In the 2012 Application the Applicants stated that the Alliance would provide an enhanced customer experience, including reciprocal premium customer benefits, and the ability of customers to earn and redeem frequent flyer points on services of the other airline on the Auckland – Hong Kong route. The Ministry assessed these benefits as “modest”.
- 4.25 Evidence from the operation of the Alliance to date shows that Air NZ's customers have benefited substantially from the ability to earn Airpoints Dollars on services operated by Cathay Pacific.<sup>10</sup> Actual Airpoints accruals have increased considerably since the Alliance commenced, rising from around [ ] accruals on the Auckland – Hong Kong route in the year immediately preceding the Alliance to over [ ] in the year to September 2014.<sup>11</sup> As Figure 4 shows, the number of accruals has consistently risen throughout the period of the Alliance, as customers have become more familiar with how Airpoints can be accrued on both Air NZ's and Cathay Pacific's Auckland – Hong Kong services.

### **Figure 4: total number of Airpoints accruals on AKL – HKG**

<sup>10</sup> We have focussed on Airpoints Dollars for the purpose of this application, given that Airpoints members are generally based in New Zealand.

<sup>11</sup> Accruals are the number of sectors (or one-way journeys) that have earned Airpoints. So [ ] accruals is [ ] one-way journeys on Auckland – Hong Kong that earned Airpoints Dollars (the value of which is discussed at paragraph 4.26 below).

- 4.26 The increase in accruals has led to a similar increase in the total Airpoints Dollars awarded to Airpoints members travelling on Auckland – Hong Kong services. In the year to September 2014, over [redacted] additional Airpoints Dollars were awarded to Airpoints Members for travel on Auckland – Hong Kong services, compared to the year immediately prior to the Alliance. This represents a [redacted]% rise in accrual rates, compared to around a [redacted]% increase in accruals across the Air New Zealand network in the 2014 financial year. This is a significant benefit for Alliance customers, particularly to business travellers, a significant proportion of whom will be Airpoints members.

#### *Lounge access*

- 4.27 The Alliance provides for reciprocal lounge access on Auckland – Hong Kong, including for customers connecting onto services beyond/behind each end of the route. Use of the Cathay Pacific lounge in Hong Kong has grown relatively steadily since the start of the Alliance, with between [redacted] Air NZ customers using the Cathay Pacific lounge in Hong Kong each month. Far greater numbers of Cathay Pacific passengers are using the Air NZ Auckland lounge, up to [redacted] per month. The difference likely reflects the availability of other facilities at Hong Kong International Airport.

#### **Stimulation of inbound tourism**

- 4.28 In the MOT Determination, the Ministry found that there was potential for the Applicants to pool marketing resources, and stimulate tourism by focussing their marketing efforts in their home markets. However, the Ministry queried whether there was much scope for the parties to increase tourism from Hong Kong.
- 4.29 In the first year of the Alliance (year ending 31 January 2014) arrivals from Hong Kong grew by 19.5% with holiday numbers growing by 30%, and in the most recent data set available (year ending 31 September 2014) arrivals grew by 8.2% with holiday arrivals growing by 9.2%.<sup>12</sup> This increase in arrivals from Hong Kong supports the view that the Alliance has helped to stimulate tourism.
- 4.30 An important element of the Alliance is the commitment of the Applicants to coordinate their marketing of the Hong Kong – Auckland route, and for Air NZ in particular the Alliance provides opportunities to promote New Zealand to Cathay Pacific's customer base. Under the Alliance, promotions which feature New Zealand as a destination are distributed through the Cathay Pacific customer databases (including Asia Miles and The Marco Polo Club). Prior to the Alliance, Air NZ would not have access to such a broad distribution network, nor would Cathay Pacific generally focus a promotion solely on New Zealand as a destination rather than as part of a broader focus on its global network.
- 4.31 Since the Alliance, the Applicants have also worked closely with Tourism New Zealand to promote New Zealand in both Hong Kong and Southern China. Together, Air NZ and Tourism New Zealand have invested over [redacted] in 2014 in an attempt to grow visitor arrivals to New Zealand from Hong Kong (split approximately 50:50), assisted by the strength of Cathay Pacific's marketing and distribution strength in its home market. Joint venture marketing activity has included separate consumer and trade campaigns, trade education and working with international media. Air NZ has also undertaken separate marketing activity in Hong Kong and Southern China. Since the suspension

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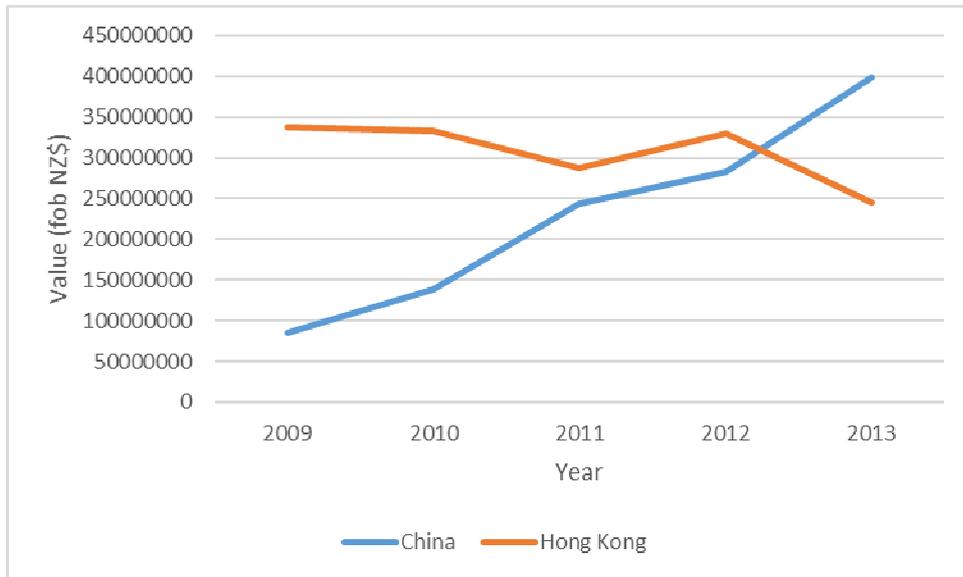
<sup>12</sup> Source: Statistics NZ.

of the Hong Kong – London route, this marketing is now focussed solely on attracting tourists from Hong Kong (and Southern China) to New Zealand, without any reduction in the overall level of marketing activity. Air NZ’s total budgeted spend for market development in Hong Kong and Southern China was just over [redacted] for FY2015.

**Continuing competition the freight market**

- 4.32 As the Ministry observed in the MOT Determination, the Alliance does not provide for the Applicants to coordinate in the freight market. Under the Alliance Air NZ and Cathay Pacific continue to market and price freight capacity separately.
- 4.33 Reauthorisation of the Alliance will allow competition between the Applicants in the freight market on the Auckland – Hong Kong sector to continue, as contrasted with the counterfactual. As the Ministry observed in the MOT Determination, the value of air freight to Hong Kong has dropped somewhat in recent years, and this trend has continued. The Applicants agree that the primary cause of this drop is likely to have been an increase in freight going directly to China (rather than via Hong Kong). Figure 5 shows the value of cargo exports to China and Hong Kong since 2009.

**Figure 5: Value of cargo exports to China and Hong Kong**  
(Source: Stats NZ value of exports from New Zealand airports)



4.34 [redacted]

- 4.35 Despite the drop in cargo value, air freight continues to be important to New Zealand – Hong Kong trade. In each year since 2009, air freight represented between 30% - 41% of total exports to Hong Kong, compared to around 15% for New Zealand exports to all destinations (and less than 5% for China). An even higher proportion of imports from Hong Kong arrive into New Zealand by air. Given the importance of air cargo for trade between New Zealand and Hong Kong, the continuing competition enabled by the Alliance remains a key benefit of the Alliance.

### Maintaining an Air New Zealand presence in a key Asian market

- 4.36 In the MOT Determination the Ministry found that one of the benefits of the Alliance was that it allowed Air NZ to maintain a presence in a key Asian market. This will continue to be a significant benefit of the Alliance.
- 4.37 As the title of the Alliance suggests, the key markets to which the Alliance connects well are those in North Asia, including mainland China, Taiwan and South Korea. Whilst the 2012 Application referred to other jurisdictions, North Asia, and in particular China, have evolved as the most important connecting market for this Alliance. This is illustrated by actual passenger flows since commencement. The first year of the Alliance saw an additional [REDACTED] passengers travelling to North Asian destinations from New Zealand, most predominantly to destinations in China. Air NZ views the Alliance as a key part of its China regional strategy. As the second biggest inbound market to New Zealand, behind Australia, and with a huge population spread across a number of different regions, sustainable access through a range of gateways is important.
- 4.38 Cathay Pacific operates to a combined 20 cities in mainland China from Hong Kong, including to a number of destinations in Southern China that are not directly served by any airline, or by services connecting into New Zealand's Shanghai service. For example, Cathay Pacific serves the Fujian cities of Nanjing (8.1m population), Fuzhou (population 7.1m) and Xiamen (3.5m), all of which are south of Shanghai and Beijing, i.e. - connections through Hong Kong avoid the backtracking and unfavourable connecting conditions for passengers (as described in paragraph 4.40 below) associated with connecting in Shanghai and Beijing. Visitors to New Zealand from the Fujian province (and other neighbouring provinces) have risen significantly since the Alliance commenced.
- 4.39 [REDACTED]
- 4.40 [REDACTED] However, the Alliance has still managed to increase China traffic for a number of reasons already discussed above, including better access and pricing for Air NZ onto Cathay Pacific's network, the timing of Air NZ's flight allowing for favourable connections into Cathay Pacific's China services, and the efforts each Applicant has made in marketing the services. Without the Alliance, Air NZ's network into China would be limited to its Shanghai service, [REDACTED] It also lacks the connection to other China destinations that the Cathay Pacific network provides. In Shanghai, there are two airports, one of which service international traffic (Pudong) and the other of which has greater domestic China services (Hongqiao). Air NZ's services to Pudong do not have good domestic connections throughout China, even though it serves the large catchment area of Shanghai well.
- 4.41 The benefit of Air NZ's presence in Hong Kong is not altered by Air NZ's alliance with Singapore Airlines and its operation of an Auckland – Singapore service from 6 January 2015. As set out in Air NZ's letter of 4 April 2014 to the Ministry in relation to the Singapore Airlines alliance, the Singapore Airlines alliance has a separate scope and purpose to the Alliance. The Singapore Airlines alliance provides Air NZ with sustainable network growth in the Pacific Rim region, and a better solution for access to the fragmented South East Asian market, particularly from a geographical perspective.
- 4.42 Despite the Singapore alliance, Air NZ expects to continue to see interline traffic flows over Hong Kong into South East Asia, due to customer preferences and seasonality of the Hong Kong gateway.

## 5. No competitive detriment

- 5.1 In the MOT Determination the Ministry found that the Alliance would remove competition for passengers travelling between New Zealand and Hong Kong. In assessing the level of competition on the route, the Ministry observed that:
- (a) China Southern's services between Guangzhou and Auckland had an almost negligible impact on the alliance's Auckland – Hong Kong services;<sup>13</sup>
  - (b) the Alliance was unlikely to have a detrimental effect on passengers travelling between New Zealand and Hong Kong to/from other destinations, as there were a range of options for passengers travelling to these destinations. These passengers formed a majority of the passengers travelling on the Auckland – Hong Kong sector (and continue to do so, see paragraph 5.4 below);
  - (c) the impact on passengers travelling between Hong Kong and New Zealand would vary. A significant proportion of travellers used indirect services between New Zealand and Hong Kong, although this proportion was less for Auckland than for other parts of New Zealand. This included travellers to/from outside Auckland (who will require an intermediate stop regardless of whether they travel via Auckland or via a third country) and leisure travellers (who are generally more price sensitive). Only business travellers from Auckland were unlikely to regard one stop services as a potential substitute; and
  - (d) the Alliance would significantly reduce the prospect of entry, although it also found that it was relatively unlikely that another carrier would enter the Auckland – Hong Kong route, with or without the alliance.
- 5.2 As set out above, in the MOT Determination the Ministry found that in the absence of the Alliance one of the Applicants would likely exit the Auckland – Hong Kong route. On this basis, competition will not be adversely affected by the Alliance. In fact, as set out further below, the Alliance increases competition on routes beyond Auckland – Hong Kong. For these reasons, the Applicants do not consider that any public detriment arises as a result of the Alliance.
- 5.3 For completeness, we comment below on market developments since the commencement of the Alliance, and how this might affect the Ministry's conclusion on competitive detriment.

### Routes other than New Zealand – Hong Kong

- 5.4 The proportion of connecting passengers on the Auckland – Hong Kong route continues to be high. For the year ending 31 August 2014, [REDACTED] of passengers flying on the Applicant's Auckland – Hong Kong services were New Zealand - Hong Kong or Hong Kong - New Zealand traffic.<sup>14</sup>
- 5.5 As the Ministry observed in the MOT Determination, there are a number of alternative options for passengers travelling beyond Hong Kong to China, other parts of Asia and to Europe. All three of these markets remain highly competitive:
- (a) **China:** passengers travelling to China are able to choose from direct services to Shanghai (Air NZ) and Guangzhou (China Southern), as well as a range of indirect services via Australia or other points in Asia. The Singapore Airlines alliance excludes China routes, meaning that Singapore Airlines competes with both Air NZ and Cathay Pacific on services into China, as do other SEA hub carriers.

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<sup>13</sup> MOT Determination, paragraph 37.

<sup>14</sup> Source: Statistics NZ data.

Since the commencement of the Alliance, China Southern has moved from a daily Auckland – Guangzhou service to a double daily service, as well as increasing capacity on its existing services. China Eastern has also announced that it will launch services on Auckland – Shanghai, which connects into a number of points in China from Pudong airport.<sup>15</sup> The range of services available into China means that this market will remain highly competitive in the future, and with the recent renegotiation of the China – New Zealand Air Services Agreement the current cap of 21 services per week will shortly increase.

- (b) **Europe:** as noted by the Ministry in its analysis of the NZ/SQ Alliance<sup>16</sup>, the market for air services between New Zealand and Europe is very competitive by industry standards, with seven independent airlines or airline alliances operating one stop services between Auckland and Europe, with various frequencies. The Ministry concluded that Europe was New Zealand’s “most competitive aviation market”. This will remain the case with or without the Alliance.
- (c) **wider Asian market:** the wider Asian market also continues to be served well with a range of direct services as well as indirect services via Australia and other parts of Asia. The most significant of these competitors is Qantas/Emirates, who operate from a number of New Zealand ports into Australia and onto its comprehensive network into Asia. The other major sources of competition are the other Asian hub carriers. These includes Singapore Airlines, as the Singapore Airlines alliance does not preclude Singapore Airlines from competing with either of the Applicants into a number of Asian markets (including China, Taiwan, and South Korea).

5.6 Importantly, the Alliance does not involve price coordination or revenue sharing on services beyond Hong Kong. Rather, each Applicant prices independently on these services and has a financial incentive to compete with its Alliance partner. This is the case even though each of the Applicants has greater access to the other’s Auckland – Hong Kong service, which it can use in competing with the other for the traffic destined to beyond points.

**Competition for services between New Zealand and Hong Kong**

5.7 [redacted] of travellers on the Hong Kong - Auckland sector are only travelling between New Zealand and Hong Kong. Competition from one-stop services between New Zealand and Hong Kong continues to provide a significant competitive constraint on the Applicants. A list of airlines currently flying one-stop services between Hong Kong and New Zealand is set out in Table 4.

**Table 4: One stop services between Hong Kong and New Zealand**

Airline	Flies via	Destinations served in New Zealand
Qantas/Jetstar	Melbourne, Sydney, Brisbane	Auckland, Wellington, Christchurch, Queenstown
Singapore Airlines	Singapore	Auckland, Christchurch
Thai Airways	Bangkok	Auckland
Air Pacific	Nadi	Auckland

<sup>15</sup> See [http://www.nzherald.co.nz/business/news/article.cfm?c\\_id=3&objectid=11334198](http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11334198).

<sup>16</sup> Ministry of Transport, *Detailed analysis to support the report to the Minister of Transport*, 28 July 2014.

Korean Air	Seoul	Auckland
Japan Airlines	Tokyo	Auckland

- 5.8 Since the MOT Determination there have been a number of developments regarding one-stop carriers between Hong Kong and New Zealand:
- Qantas/Emirates have increased overall capacity into Hong Kong from the east coast of Australia, with a 54% increase in capacity from Brisbane (Melbourne capacity has remained flat while Sydney capacity has decreased 14%). This complements Emirates' introduction of its A380s across the Tasman (most recently on Auckland – Brisbane). Qantas/Emirates provides a significant one-stop constraint on the Applicant's New Zealand – Hong Kong services;
  - Fiji Airlines has increased frequency on Hong Kong – Nadi by 50% (an 18% capacity increase). Fiji Airways operates 11 weekly flights on Auckland – Nadi and a weekly flights on Christchurch – Nadi (a second seasonal Christchurch – Nadi flight was introduced in 2013);
  - Malaysia Airlines has increased capacity and frequency by 9% on Hong Kong – Kuala Lumpur, while maintaining capacity on its Auckland – Kuala Lumpur service;
  - Korean Airlines has slightly reduced frequency (by around 5%) on Hong Kong – Seoul, but have increased capacity overall by 3% due to changes to their aircraft mix;
  - Thai Airways reduced frequency by 11% on Bangkok – Hong Kong, although capacity change is unknown due to the different types of B777 aircraft used on this route; and
  - Jetstar Asia has exited the Singapore – Auckland route. However, some reports have suggested that Jetstar Hong Kong is moving closer to solving its regulatory issues, and could commence operations early next year.<sup>17</sup>
- 5.9 Air NZ's own share data shows that one stop carriers, in particular those carriers operating through Australia, have a significant and increasing share for travellers between New Zealand and Hong Kong.

**Table 5: share estimates for Hong Kong – New Zealand vv**

Source: Stats NZ (no carrier breakdown is available for the HKG – AUS leg for Tasman arrivals/departures)

	Pre-Alliance (1 Feb 2012 – 31 Jan 2013)	First Alliance year (1 Feb 2012 – 31 Jan 2014)	Past financial year (July 2013 – June 2014)
<b>share vv</b>	<b>Non-stop</b>		
NZ via HKG	30.6%	33.0%	33.3%
CX via HKG	40.2%	35.3%	33.6%
<b>NZL-HKG vv</b>	<b>One-stops</b>		
Tasman share <sup>18</sup>	14.9%	19.5%	22.6%
SQ/Jetstar via SIN	7.9%	6.7%	5.3%
MH via KUL	0.7%	1.8%	1.2%
FJ via NAN	0.4%	0.6%	0.6%
CZ via CAN	0.4%	0.3%	0.5%

<sup>17</sup> See <http://www.smh.com.au/business/aviation/qantas-moves-closer-to-hong-kong-jetstar-remedy-20140831-10ajxd.html>.

<sup>18</sup> The Applicants are unable to determine carrier specific data for passengers travelling via Australia.

TG via BKK	0.2%	0.2%	0.4%
KE via ICN	0.2%	0.1%	0.2%
Others/Unknown	4.6%	2.4%	2.4%

- 5.10 As Table 5 shows, the Applicants' share on the Hong Kong – New Zealand routes has reduced since the commencement of the Alliance. This is despite the fact that total traffic on the route has increased by around 5,000 passengers.<sup>19</sup> The fall in share appears to have arisen as a result of increasing competition from Tasman carriers, due to a combination of low fares and increased capacity across the Tasman, together with fifth freedoms carriers feeding a highly competitive Australia – Hong Kong market. Another reason for the Applicants' lower market share on Hong Kong – New Zealand may be each Applicants' success in stimulating travel beyond Hong Kong, and in particular to China.
- 5.11 In the MOT Determination the Ministry expressed a particular concern regarding Auckland travellers, who were considered as less likely to favour a one-stop service. However, as Table 6 shows, the shift in share extends to Auckland passengers. In the MOT Determination, the Ministry found that 17% of Auckland passengers on the Auckland – Hong Kong route travelled indirectly. That has risen to 24% for the year ended 20 July 2014, similar to many other New Zealand regions.

**Table 6: Location of New Zealand residents departing New Zealand to Hong Kong (year ended 2014)**  
(source: Stats NZ)

Region	Direct Route (AKL-HKG)		Indirect routes (e.g. primarily via Aus)	
	Passengers	%	Passengers	%
Auckland	8920	76%	2780	24%
Wellington	1640	73%	600	27%
Other North Island	1360	66%	700	34%
Christchurch City	1280	77%	380	23%
Other South Island	1080	79%	280	21%
Total	14280	75%	4740	25%

- 5.12 The Ministry found that business travellers were the least likely to see one stop options as a suitable substitute, and therefore a constraint on the Applicants. The Applicants note that Air NZ's own figures in Table 7 show that the proportion of business travellers using one stop services is not particularly different from that for other purposes of travel.

<sup>19</sup> Total passenger numbers have increased from almost 44,000 passengers to just under 49,000. (Source: Stats NZ)

**Table 7: Travel by type: New Zealand and Hong Kong**  
(source: Stats NZ and Air NZ's own figures)

	Pre Alliance (year ending 31/01/13)	NZ/CX Share	Post Alliance (year ending 31/01/14)	NZ/CX share
Business	[ ]	[ ]	[ ]	[ ]
Conventions/Conferences	[ ]	[ ]	[ ]	[ ]
Business & Conference	[ ]	[ ]	[ ]	[ ]
Education	[ ]	[ ]	[ ]	[ ]
Holiday	[ ]	[ ]	[ ]	[ ]
VFR	[ ]	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]	[ ]
<b>Total</b>	[ ]	[ ]	[ ]	[ ]

5.13 Even if the MOT Determination is correct in stating that business passengers are most likely to experience detriment from the Alliance, business passengers are best placed to obtain the benefits created by the Alliance. As noted in the MOT Determination, time of day and FFP/premium customer benefits are most likely to accrue to passengers who (before the Alliance) had a reason to travel on one airline over the other. Business passengers, who will typically be required to book with a particular carrier under their preferred airline travel policy and/or who will be premium members of an airline's loyalty scheme, are therefore the passengers who are the most likely to previously have been loyal to one airline over another, and who can now benefit from the choice of services offered by the Alliance. Of course, business passengers are also far better off with the Alliance than they would be in the counterfactual.

**Potential for entry**

5.14 The Applicants agree with the Ministry's views in the MOT Determination that the potential for entry onto the Auckland – Hong Kong route will be low, although Auckland Airport has recently stated that they are speaking to a number of Southeast Asian and North Asian carriers about flying to Auckland.<sup>20</sup>

5.15 However, the Applicants do not consider that the Alliance creates any additional barriers to entry in the market. Given [ ] and the current positions of likely entrants (for example, Qantas/Jetstar and Jetstar Hong Kong), the likelihood of entry would be the low with or without the Alliance. Therefore, it is unlikely that the Alliance has a significant impact on the prospects for entry.

**Auckland - Hong Kong fares have remained at competitive levels**

5.16 In the MOT Determination the Ministry raised concerns regarding the potential for fares to rise, and capacity to fall, on the Auckland – Hong Kong route as a result of the Alliance. This was balanced against the fact that the Ministry concluded that in the absence of the Alliance one of the carriers would likely exit the Auckland – Hong Kong route. The constraint on the Applicants arising from the various competing services described above is reflected in the fact that capacity has largely remained the same, and fares have remained at competitive levels, despite the Applicants no longer competing for New Zealand – Hong Kong point to point travellers.

5.17 The Ministry's concerns regarding capacity have not materialised. The Applicants have retained the same frequency as prior to the Alliance. They have also constantly

<sup>20</sup> [http://www.nzherald.co.nz/business/news/article.cfm?c\\_id=3&objectid=11223288](http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11223288)

reviewed when they can extend Cathay Pacific's double daily flying, which has resulted in the 2014/5 Northern Winter schedule being extended by an additional two weeks in February/March. Cathay Pacific has improved its product on the route, by adding in a new premium economy class. While this is not a benefit that is directly related to the Alliance, it is a positive development, as the Applicants now operate the same 3-cabin configuration and can freely sell into each other's premium economy cabin.

- 5.18 Pricing has also remained at competitive levels on the Auckland – Hong Kong route. Average fares for New Zealand point of sale have decreased on all fare classes on Alliance services, while total traffic has increased by [redacted]%.<sup>21</sup> In the MOT Determination the Ministry found that Auckland based business travellers were the group most likely to experience detriment from the Alliance. However, average fares for New Zealand passengers have decreased in both the business ([redacted]% lower) and premium economy classes ([redacted]%). This is despite the fact that a significantly higher proportion of customers are travelling in premium classes due to introduction of Cathay Pacific's premium economy cabin. For the purposes of the Ministry's analysis, the average fare decreases are a significant benefit for New Zealand based passengers.
- 5.19 For the purpose of assessing the impact on the New Zealand public, New Zealand point of sale pricing and tourism are key considerations.
- 5.20 As noted above, New Zealand point of sale pricing has fallen. In terms of tourism, since the commencement of the Alliance, inbound tourism from Hong Kong has increased, as has inbound tourism from China via Hong Kong.<sup>22</sup> However, the average fare sold by the Applicants in Hong Kong has increased by [redacted]%. The primary reasons for the increase in average fare include:
- (a) the introduction of premium economy onto Cathay Pacific's services, resulting in a significant increase in Hong Kong based passengers choosing to purchase premium economy (an increase of [redacted]% across both airlines in the last year, compared to the year immediately preceding the Alliance). While this offering was introduced in response to consumer demand, when consumers pay the higher price for this better product (which also costs more to supply) the average fare across the aircraft will also rise.<sup>23</sup> This change (and the resulting fare increase) would have occurred even in the absence of the Alliance;
  - (b) the Alliance offering has proven very popular for passengers travelling between China and New Zealand over Hong Kong, which has resulted in a change to the mix in traffic on the sector. Tactical fares are still available to the Hong Kong market but there has been greater demand from China on the route. Average economy class fares paid by Hong Kong passengers have [redacted]. Meanwhile [redacted]. Overall, average revenue per passenger on the sector has [redacted]; and
  - (c) Hong Kong's inflation rate, which is over 4% per annum (4.3% for the 2013 calendar year and 4.2% for the year ended 30 September 2014).<sup>24</sup> This is relatively high by international standards, compared to inflation of 1.1% in New Zealand and the OECD average of 1.6%.<sup>25</sup>

<sup>21</sup> Data is for the period immediately prior to the Alliance (Feb 2012 – Jan 2013) compared to the post alliance period from July 2013 to July 2014.

<sup>22</sup> Source: Stats NZ tourism figures as at September 2014.

<sup>23</sup> For example, assuming a 100% load factor, a Cathay Pacific flight will now have 28 passengers flying in premium economy and 46 less passengers flying in economy. All other things being equal, average fares across the cabin will increase due to both the displacement of economy passengers with premium passengers, and the lower number of economy passengers.

<sup>24</sup> Source: Hong Kong Census and Statistics Department.

<sup>25</sup> Source: OECD website. Note that Hong Kong is not part of the OECD.

6. **NO LEGAL REASONS FOR THE MINISTER REFUSING TO AUTHORISE THE ALLIANCE**

**No Legal Reasons for the Minister Refusing to Authorise the Alliance**

- 6.1 Sections 88(3) and (4) of the CAA provide specific reasons for the Minister to decline to authorise, although they are subject to an override in section 88(5) if the Minister believes that to decline authorisation would have an undesirable effect on international comity. For the reasons discussed below none of the reasons set out in sections 88(3) and (4) apply in respect of the Alliance.
- 6.2 The MOT Determination accepted that the Alliance did not fall foul of any of the prohibitions set out in sections 88(3) and 88(4) of the CAA, and that the agreements were capable of being authorised under the CAA. We do not consider that there have been any material changes to the Alliance that would warrant a change to the conclusions in the MOT Determination.

**No infringement of section 88(3)**

- 6.3 Nothing has occurred in the period since authorisation which should cause the MOT to depart from its earlier view that authorisation of the Alliance is consistent with the relevant arrangements in section 88(3) and would not arrangements is will not prejudice compliance with any relevant international convention, agreement, or arrangement to which the Government of New Zealand is a party.<sup>26</sup>

**No infringement of section 88(4)**

- 6.4 The MOT Determination concluded that “[t]here are no provisions in the Alliance Agreement or the Code Share Agreement that fall within any of the prohibitions in section 88(4) of the Act. This remains the case; there has been no material changes to the Alliance which would alter this conclusion:
- (a) No infringement of section 88(4)(a): As noted in the MOT Determination, the “Agreements do not contain any provisions that provide for enforcement through fines or market pressures.”<sup>27</sup>
  - (b) No infringement of section 88(4)(b): The Applicants understands that there has been no change to the commission regimes issued by the Minister which are currently in force under section 89 of the CAA are the Civil Aviation (Passenger Agents’ Commission Regime) Notice 1983 and the Civil Aviation (Cargo Agents’ Commission Regime) Notice 1983. Nor has there been any change to the relevant provisions in the NAAA identified in the MOT Determination. Therefore, the MOT’s earlier conclusion continues to be correct, i.e. that the provisions do not have the purpose or effect of breaching the terms of either of the commission regimes.<sup>28</sup>
  - (c) No infringement of section 88(4)(c): As noted in the MOT Determination (at Annex A, paragraph 13), “The Agreements do not contain any provisions that unjustifiably discriminate between consumers in terms of this paragraph.” As described [above], the Alliance will continue to provide benefits to all consumers travelling between New Zealand and Hong Kong, and beyond.
  - (d) No infringement of section 88(4)(d): As set out in the MOT Determination, the exclusivity clauses in the NAAA (which have not changed since the MOT

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<sup>26</sup> MOT Determination, Annex A, paragraph 7.

<sup>27</sup> MOT Determination, Annex A, paragraph 8.

<sup>28</sup> MOT Determination, Annex A, paragraph 11.

Determination) do not have the effect of excluding any supplier of international carriage by air from participating in the market to which they relate.<sup>29</sup>

- (e) No infringement of section 88(4)(e): nothing has occurred in the period since authorisation which should cause the MOT to depart from its view that the agreements do not contain any provision which 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.
- (f) No infringement of section 88(4)(f): The MOT Determination stated that the “The Agreements do not contain any provisions that prevent any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding”.<sup>30</sup> The Applicants believe this conclusion remains correct and thus s88(4)(e) does not give rise to a reason for declining authorisation.

### **International comity**

- 6.5 The Applicants note the MOT’s conclusion that declining authorisation would not have an undesirable effect on international comity.<sup>31</sup> The Applicants remain of the view that declining authorisation would have an undesirable effect on international comity between New Zealand and Hong Kong and as a result, international comity provides a distinct reason for the Minister to exercise his discretion in favour of authorising the Alliance.

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<sup>29</sup> MOT Determination, Annex A, paragraph 17.

<sup>30</sup> MOT Determination, Annex A, paragraph 27.

<sup>31</sup> MOT Determination, Annex A, paragraph 34.

Schedule A

**Restated North Asia Alliance Agreement and Codeshare Agreement**

**Schedule B**  
**Amendment Agreement**