

**SUBMISSION ON APPLICATION TO THE MINISTER OF TRANSPORT
PURSUANT TO PART 9 OF THE CIVIL AVIATION ACT 1990 FOR
AUTHORISATION OF THE AIR NEW ZEALAND AND AIR CHINA STRATEGIC
ALLIANCE**

1 May 2015

Introduction

- 1 Christchurch International Airport Limited (*CIAL*) welcomes the opportunity to submit to the Ministry of Transport (*MOT*) on the application by Air New Zealand Limited (*Air NZ*) and Air China Limited (*Air China*) (together, the *Airlines*) for authorisation under section 88 of the Civil Aviation Act 1990 (*CAA*) of their Strategic Alliance Agreement (*SAA*) and related agreements, (the *Alliance*), for a five year term.
- 2 *CIAL*'s submission is based on our review of the Airline's redacted application for authorisation to the *MOT*. A number of key aspects of that application remain confidential, including data in support of the Airlines' claimed public benefits. Our submission should be read in that context.

Key points

- 3 *CIAL* recommends that the *MOT* undertake a rigorous analysis of whether the authorisation is in the wider New Zealand public interest, having regard to:
 - 3.1 actual and demonstrable evidence as to the likelihood that the public benefits claimed by the Airlines will actually be delivered by the Alliance and that those benefits will provide a material public benefit; and
 - 3.2 taking note of other options the Airlines might have to structure their relationship, whether those benefits might be achieved without the need for Ministerial intervention in competitive markets; and
 - 3.3 whether an otherwise anti-competitive alliance is necessary to deliver the claimed benefits; and
 - 3.4 the impact of the Alliance on regional economic development as a public benefit (and interest); and
 - 3.5 whether these claimed benefits outweigh the potential detriments associated with the Alliance.
- 4 The South Island's tourism and freight industries are of both national and regional economic significance and depend on frequent, direct international air services, especially with Asian hubs to provide crucial connectivity to key Asian and other international markets. Before granting a further authorisation, the *MOT* should be comfortable that the Alliance, whether in isolation or in conjunction with other alliances, will not:
 - 4.1 have the practical effect of foreclosing the potential for such international air services to the South Island; and
 - 4.2 undermine the objectives of the Government's "open skies" policy.

- 5 Prior to finalising its recommendation on the Alliance, we strongly encourage the MOT to:
 - 5.1 consult on its proposed framework for assessing detriments and benefits,
 - 5.2 outline clearly how evidence of claimed benefits will be monitored and tracked following any authorisation so practical outcomes are transparent against claimed benefits, during the term of the Alliance and
 - 5.3 in relation to the Alliance specifically, issue a draft decision outlining its testing of detriments and benefits.
- 6 If the MOT is minded to authorise, we recommend authorisation for the shortest period the MOT determines is necessary to allow the claimed public benefits to be more clearly evidenced and to ensure those benefits are distributed within New Zealand to give the best economic outcomes.

Framework for MOT analysis

- 7 Unless the Alliance triggers certain prohibitions set out in sections 88(3) or (4) of the CAA, approval of the Alliance is at the discretion of the Minister, to be exercised in the public interest. Or, prior to Ministerial intervention in a competitive aviation market, the benefits must outweigh said intervention. The public interest involves weighing up the balance between the benefits from the Alliance and any potential detriments to competitive market dynamics.
- 8 A decision to authorise the Alliance must be supported by real evidence that public benefits have been (or will be) actually derived from the Alliance such that the identified potential detriments have been (or will be) outweighed.

Public benefits

- 9 The Alliance partners claim the public benefits of the Alliance as being:
 - 9.1 immediate creation of a new direct Auckland – Beijing service and securing the sustainability of existing Auckland – Shanghai service;
 - 9.2 opportunities for New Zealand suppliers;
 - 9.3 premium customer handling, lounge and FFP benefits;
 - 9.4 greater online connectivity;
 - 9.5 competition with other carriers; and
 - 9.6 stimulation of tourism.
- 10 CIAL accepts that the additional services referred to in paragraph 8.1 may result in a public benefit however, that aside, the public version of the application for authorisation produces very little, if any, evidence to demonstrate:
 - 10.1 either the likelihood of the claimed benefits in fact arising or the actual claimed value of them to the New Zealand public generally. It is for example unlikely the benefits set out at paragraphs 8.2 to 8.4 are of any material significance from a public benefit perspective; or

- 10.2 whether the claimed benefits are able to be otherwise achieved for, or by, the New Zealand public without the authorisation of an otherwise anti-competitive alliance.
- 11 The application for authorisation provides no understanding as to what is or maybe required for the additional services to be sustainable by either the existing airlines or other potential airlines, or evidence that one airline being unable to sustain a specific air sector means it will hold true that it will not be sustainable for other airlines over the term of the Alliance.
- 12 Significantly the application for authorisation does not provide any evidence to support the assertion the Alliance will deliver the claimed benefits described at paragraphs 7.5 and 7.6.
- 13 The ACCC expressed scepticism as to the likelihood of public benefits arising in its draft determination proposing to deny authorisation to Qantas Airways Limited and China Eastern Airlines Corporation Limited to coordinate their operations between Australia and China pursuant to a Joint Coordination Agreement
- 14 For the reasons set out below CIAL requests the MOT conduct a rigorous examination of any such claimed benefits.

Regional Economic Benefits to the South Island unlikely

- 15 The South Island economy depends on effective international connectivity with key international markets, like Asia, to sustain its tourism and export air freight industries. International air connectivity is also a key plank for the ability of a city and region to attract international talent and export education opportunities.
- 16 MBIE's official tourism statistics indicate that regions within the South Island derive a greater benefit from direct international connectivity than via indirect connectivity over other New Zealand ports. Those industries and regions are of national significance, and the opportunity for increased international air services to the region are key to both recovery in the wake of the Canterbury Earthquakes and export driven regional economic growth opportunities. It follows that the effect of the Alliance on international air service opportunities between Asia and Christchurch and the South Island should be front of mind for the MOT.
- 17 In the absence of a direct service to Christchurch (which, although not without reason, is acknowledged as unlikely at present) the public benefits claimed the Alliance will be limited as:
- 17.1 there will be fewer, if any, direct benefits to South Island exporters;
- 17.2 the stimulation of South Island tourism will be limited to sub optimal outcomes and ultimately opportunities will be diluted;
- 17.3 due to the diluted distribution of benefits that arise when Auckland is the port of entry, the public benefits for the South Island will be significantly less than claimed; and
- 17.4 opportunities for talent attraction and export education will be diminished.

Limited benefit to South Island exporters

- 18 Direct services between CHC-China are crucial to the South Island's air freight reliant industries, as importers and exporters in the region depend on the belly hold freight in commercial services (wide body especially) to reach international markets efficiently and cost effectively.
- 19 The benefits of the air freight capacity provided by international passenger services were explained in PWC's 2011 independent review of the South Island air freight sector, 'Opening the South', commissioned by the Canterbury Development Corporation and CIAL (a copy of which is **attached**). This analysis was updated in 2015 and highlights the potential gap in air freight through Christchurch Airport has increased by 8% over the last 3 years to more than 32,000 tonnes of total freight on an annual basis. Assuming a capacity of 110 tonnes for a fully laden Boeing 747, this equates to approximately 290 fully loaded freighters coming to and from Christchurch Airport each year.
- 20 As the Alliance does not propose to add a CHC - China sector it will have little, if any, noticeable positive impact on SI exporter's currently decreasing ability to efficiently access important Chinese and Asian markets. The public version of the application for authorisation contains no evidence as to how South Island exporters will derive benefits from the Alliance greater than those they already enjoy.

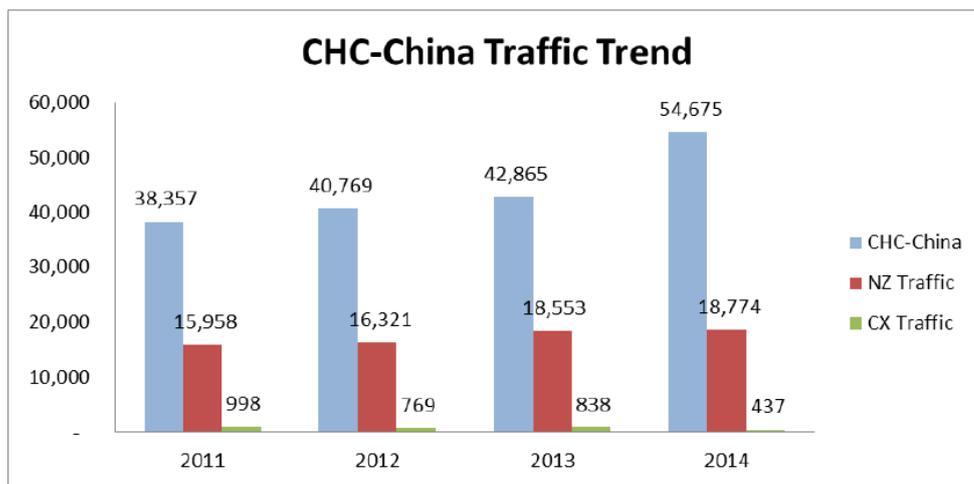
Limited stimulation of South Island tourism

- 21 The South Island's tourism industry is of national importance. The South Island visitor economy is worth around \$5,817m annually and employs circa 62,300 people. Of that, the Christchurch visitor economy is worth circa \$1,263m annually and employs circa 13,500 people.¹
- 22 The economic benefits of getting Chinese and North Asian visitors direct to the region are significant. For example:
- 22.1 in the most significant source market, China, an international visitor survey completed by Tourism NZ in 2013 showed that Chinese visitors to the South Island stayed considerably longer in New Zealand than those who didn't visit the South Island (17.4 nights vs 6.2 nights), spent more money (\$3,499 pp vs \$2,969 pp), and were overall more satisfied with their trip to New Zealand;² and
- 22.2 approximately 70% of international arrivals to CHC will go on to visit other regions in the South Island. Only 7% of international visitors arriving in Queenstown will venture outside the region to other parts of the South Island.
- 23 The South Island share of Chinese and North Asian visitors is underrepresented when compared with its share of total visitor arrivals. Growing direct volumes of visitors to and from North Asia markets is critical for growing regional South Island economies.

¹ Source: CIAL analysis based on international and domestic visitor surveys. All figures have been recalibrated to MBIE's regional expenditure estimates.

² Source: MBIE International Visitor Survey.

- 24 Although the overall trend is for passenger traffic growth between CHC - China, that has not been accompanied by corresponding growth in the Airlines' combined passenger traffic between CHC-China.



Source: IATA AirportIS

- 25 CIAL supports initiatives which will lead not only to an actual increase in tourism numbers to New Zealand but importantly also a greater regional distribution of the economic and social benefits. CIAL welcomes the Alliances intention to increase "mono tourism" and agrees that travellers tend to stay longer and spend more as a result. For the reasons referred to below the regional South Island benefit of this is however greatly diluted when their entry point is Auckland.
- 26 South Island regional economies are best stimulated with direct international air connections. The MOT should conduct a detailed analysis to be satisfied the Alliance (potentially together with other alliances and code sharing agreements) does not practically contribute to the reduction in opportunity for future direct air international services to destinations other than AKL.
- 27 The Alliance suggests the need to fill the new capacity will stimulate marketing initiatives at both ends of the route, but provides no detail of these initiatives. We recommend that the MOT request the airlines provide evidence of any proposed initiatives and carry out a detailed analysis of those marketing initiatives to determine whether they will actually lead to (firstly) an increase in, and (secondly) a regional distribution of, economic benefits. This analysis should also consider what impacts, if any, these initiatives would have on other routes or other potential airline competition, both direct and indirect.

Limited distribution of benefits where Auckland is port of entry

- 28 The NZ port of entry for direct long-haul routes is the key factor in determining which regions in New Zealand capture the benefits of connecting with these markets.
- 29 The South Island suffers a significant dilution in opportunity value per visitor when the international entry point is not in the South Island. For example, for flights to New Zealand from Asia (excluding Australia) over the period October 2010 – June 2013, holiday visitors spent an average of:

- (a) 77% of their time in the South Island where their airport of arrival was CHC; against
- (b) 36% of their time in the South Island where their airport of arrival was AKL.

This means while there may be national benefits arising from an increase in the number of travellers originating from Beijing to New Zealand the regional distribution of those benefits through New Zealand will be significantly impacted by the port on entry.

Need to determine accumulated foreclosure effect of alliances and undermining of “open skies”

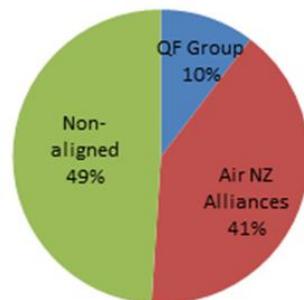
- 30 A relevant factor to be taken into consideration by the MOT is the cumulative effect of alliance applications and existing alliance arrangements. Specifically we refer to the Cathay Pacific/Air NZ application for authorisation currently under consideration.
- 31 The proliferation of these types of alliances raises real questions as to the likely effectiveness of the Government’s “open skies” policies. CIAL does not see how “open skies” will facilitate alternative future direct routes increasing the South Island’s international connectivity if these types of anti-competitive arrangements are authorised without a rigorous consideration of their cumulative effect.
- 32 The Airlines claim at paragraph 2.29 of their application that the presence of the Alliance is unlikely to discourage other Chinese domiciled carriers from serving the inbound Chinese-New Zealand market. The Airlines are unable to point to any specific evidence to support its assertion and the most recent example of the Cathay Pacific/Air NZ alliance between Hong Kong and New Zealand clearly demonstrates that alliances do negatively impact the competitive environment.
- 33 We recommend the MOT take this opportunity to critically evaluate and determine the combined effect the Alliance and other alliances may have on the ability of other carriers to fly international air services to New Zealand, including to points of entry other than Auckland.

Impact on competing carriers

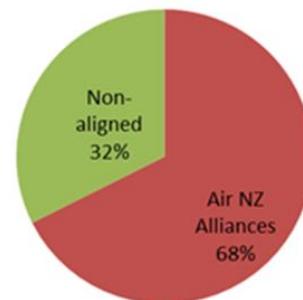
- 34 It is unlikely an alliance operating with the benefit of an anti-competitive authorisation will be incentivised to deliver the claimed competitive benefit. The public version of the application for authorisation produces no evidence as to either the likelihood of this occurring or what steps the Alliance has, or will, put in place to ensure this occurs.
- 35 Improving revenue and load factors are stated as objectives of the Alliance. As the MOT can neither impose conditions on the Alliance including how to manage its yields and capacity to achieve this outcome it is difficult to determine from the application for authorisation how competition with other carriers will be promoted.
- 36 Further, two key features of the market (as shaped by the Alliance and the cumulative effects of other Air NZ alliances) make it difficult for competing carriers to offer alternative long haul services to other New Zealand locations from North Asian destinations.

37 First, Air NZ controls most of the international long haul capacity through AKL (both independently and by way of its various alliances) reinforcing AKL’s fortress position as Air NZ’s primary hub. This makes it difficult for an independent carrier to establish viable services that service AKL and materially more difficult to service ports in New Zealand outside Auckland. The following graphs illustrate the share of capacity through AKL that is controlled via alliances, and in particular Air NZ alliances, is increasing.³ The Alliance will only contribute to that skew further in favour of Air NZ alliances.

Seat Share 2011 (Long haul)



Seat Share 2015 (Long haul)



38 The cumulative effect of these alliances is to lock up the market and deter new entrants offering direct services to New Zealand and in particular to other parts of New Zealand.

39 The emphasis on Auckland means that a new entrant carrier’s ability to service other locations would be dependent on competitive and reliable access to Air NZ’s domestic network - leading to the second factor deterring new entry: Air NZ, through its domestic network (which accounts for 79% of domestic seat share in New Zealand), is uniquely positioned to control the ability of other long haul carriers to compete with it at any port within New Zealand.⁴

Term of reauthorisation

40 We recommend the MOT only authorise the Alliance for the shortest period it determines necessary to allow the claimed public benefits to be more clearly evidenced and to ensure those benefits are distributed within New Zealand to give the best economic outcomes.

³ Source: IATA AirportIS. Note that these graphs exclude Trans-Tasman and Pacific Island seats.

⁴ Source: IATA AirportIS for published seat share in 2015.