



Australian
Competition &
Consumer
Commission

Draft Determination

Application/s for authorisation

lodged by

Etihad and Air Berlin

in respect of

a Commercial Alliance

Date: 27 June 2012

Authorisation no.: A91307 &
A91308

Public Register no.: C2012/308

Commissioners: Schaper
Rickard
Dimasi
Walker
Willett

Summary

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The ACCC proposes to grant authorisation for ten years to Etihad and Air Berlin to make, and give effect to, a Commercial Alliance. Under the Commercial Alliance the applicants will coordinate on international air passenger transport and air cargo transportation services between Australia and the Middle East/South East Asia and between Australia and Germany.

Next steps

The ACCC will seek further submissions in relation to this draft determination before making its final decision. The applicants and interested parties may also request a pre-decision conference be held to allow oral submissions on the draft determination.

1. The applicants and application for authorisation

- 1.1. On 26 April 2012, Etihad Airways PJSC (Etihad) and Air Berlin PLC & Co. Luftverkehrs KG (Air Berlin) (together ‘the applicants’) lodged authorisation applications A91307 & A91308 with the ACCC under sections 88(1A) and 88(1) of the *Competition and Consumer Act 2010* (the Act). The applicants also requested interim authorisation under section 91 of the Act, which the ACCC granted on 16 May 2012.
- 1.2. Etihad is the national airline of the United Arab Emirates, and was established by Royal (Emiri) Decree in July 2003. Etihad is a full service network carrier which operates flights to 72 destinations in 48 countries, including Australia. Etihad operates 21 flights per week between Abu Dhabi and Sydney, Brisbane and Melbourne.
- 1.3. Etihad has entered into codeshare arrangement with Air New Zealand. Etihad codeshares¹ on all of Air New Zealand’s trans-Tasman routes and the majority of New Zealand domestic services. Air New Zealand codeshares on Etihad’s services between Abu Dhabi and Brisbane, Sydney and Melbourne and three behind routes² to European destinations.
- 1.4. Etihad has also entered into an Alliance with Virgin Australia, which was approved by the ACCC in 2011 and includes a commercial cooperation agreement, a frequent flyer agreement and a reciprocal lounge access agreement.
- 1.5. Air Berlin is the second largest airline in Germany, and sixth largest in Europe. Air Berlin is a publicly listed company, whose single largest shareholder is Etihad with 29.21% of issued capital. Air Berlin is a full service network carrier operating out of four hubs: Dusseldorf, Berlin, Vienna and Palma de Mallorca. The majority of its aircraft types have a maximum range of 5,700 kilometres or less. Air Berlin operates flights to 162 destinations in 40 countries, most of which are in Europe. Air Berlin does not currently operate any flights into or out of Australia.

¹ Codesharing refers to arrangements involving the assignment of one airline’s designator code to a flight operated by another airline

² Behind routes refers to complimentary segments behind the originating destination. For example on a route between Sydney and Abu Dhabi, behind routes may include Auckland to Sydney.

1.6. The applicants seek authorisation to implement a Commercial Alliance. Under the Commercial Alliance the applicants will coordinate on international passenger transportation and air cargo transportation services between Australia and the Middle East/South East Asia and between Australia and Germany. The Commercial Alliance contemplates cooperation on:

- Joint pricing
- Joint route and schedule coordination
- Joint marketing distribution and sales representation
- Other cooperative activities including:
 - freesale³ code sharing;
 - reciprocal preferred fare pro-ration⁴;
 - reciprocal frequent flyer programs;
 - reciprocal lounge access;
 - staff travel and staff exchange;
 - codeshare product development;
 - seamless full service transfers;
 - consolidation of sales offices;
 - global sales agreement to support sales in the United Arab Emirates;
 - joint travel agent and corporate account dealing;
 - joint airport representation and handling; and
 - belly hold capacity services⁵.
- Other future initiatives including:
 - cargo;
 - transfers;
 - product innovation;
 - sharing of airport facilities;
 - support services;
 - technical and maintenance services;
 - procurement of goods and services;
 - alignment of service levels; and
 - information technology and training.

1.7. The applicants state that the commercial alliance will not involve the sharing of revenues or profits.

³ Freesale refers to a type of codeshare where the marketing carrier effectively only pays for the seats it sells

⁴ Pro-rate agreements provide for two-way interlining of air passenger services. Typically, each airline pays the other revenue on a pro-rata basis depending on the section of the route operated by the respective carrier. For example, if a passenger purchases a fare with Etihad for a journey where separate sections of the route are operated by each of Etihad and Air Berlin, Air Berlin receives a portion of the fare pro-rated to the section operated by Air Berlin.

⁵ Belly hold capacity services refers to utilising capacity in the belly of the aircraft for cargo.

2. Submissions received by the ACCC

- 2.1. The ACCC received one submission in relation to the applications for authorisation, from Malaysia Airlines, which did not object to the Commercial Alliance.

3. ACCC Evaluation

- 3.1. The ACCC's evaluation of the proposed Commercial Alliance is in accordance with the relevant net public benefit tests⁶ contained in the Act. While there is some variation in the language of the tests, in broad terms, the ACCC is required to identify and assess the likely public benefits and detriments arising from the conduct, including those constituted by any lessening of competition. The ACCC may grant authorisation if it is satisfied that the benefit to the public would outweigh the public detriments.

The market

- 3.2. For the purpose of assessing this application the ACCC considers the relevant areas of competition are the markets for:
- international air passenger transport services between (i) Australia and the Middle East/South East Asia, and (ii) Australia and Europe; and
 - international air cargo transport services between (i) Australia and the Middle East/South East Asia, and (ii) Australia and Europe.
- 3.3. The ACCC considers that, while there may be separate international air passenger transport service markets for leisure and business passengers and for direct services and indirect (one or more stop) services, the outcome of the competition assessment in this matter is not materially impacted by such distinctions.
- 3.4. The ACCC considers that the relevant air cargo transport services market includes not only direct services but also indirect services between points in Australia and points in the Middle East/South East Asia and between points in Australia and points in Europe.

The counterfactual

- 3.5. The ACCC applies the 'future with-and-without test' (or 'counterfactual'), as established by the Australian Competition Tribunal (the Tribunal) to identify and weigh the public benefit and public detriment generated by conduct for which authorisation has been sought.⁷
- 3.6. Under this test, the ACCC compares the public benefit and anti-competitive detriment generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted.

⁶ Sections 90(8), (6), (7), (5A) and (5B)

⁷ *Australian Performing Rights Association* (1999) ATPR 41-701 at 42,936. See also for example: *Australian Association of Pathology Practices Incorporated* (2004) ATPR 41-985 at 48,556; *Re Media Council of Australia* (No.2) (1987) ATPR 40-774 at 48,419.

- 3.7. The ACCC considers that without authorisation:
- The applicants would not proceed with the Commercial Alliance;
 - Etihad would continue to operate flights between Australia and the Middle East/South East Asia and between Australia and Europe (including Germany); and
 - Air Berlin would continue its existing operations and would be unlikely to commence standalone flights between Australia and the Middle East/South East Asia.

Public benefits

- 3.8. Public benefit is not defined in the Act. However, the Tribunal has stated that the term should be given its widest possible meaning. In particular, it includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress.⁸

- 3.9. The applicants submit that as a result of the Commercial Alliance they will be able to offer:

- enhanced products and services, including:
 - increased convenience;
 - the increased likelihood of making the connecting flight in the event of a delay on a journey sector;
 - the increased ability to purchase flexible fares;
 - reduced likelihood of luggage being lost;
 - the ability to fly on one's preferred air service brand and to accrue points and status credits; and
 - in relation to codeshare services, they will frequently be able to offer lower prices.
- the establishment of an Air Berlin Australia network; and
- stimulation of Australian tourism.

- 3.10. The ACCC's assessment of the likely public benefit of the Commercial Alliance is as follows:

Enhanced products and services

- 3.11. The ACCC recognises that when airlines that provide complementary services act independently, the effect that each airline has on the demand for the other airline's services is not taken into account by either party in planning products and services. The consequence of this 'externality'⁹ can include less convenient connections for passengers, higher fares/cargo charges, less attractive customer reward programs and/or

⁸ *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,677. See also *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,242.

⁹ An externality is an economic term referring to a cost or benefit that affects a third party (a party who did not agree to the action causing the cost or benefit) and is not reflected in market prices. In the presence of an externality, market prices do not reflect the full costs or benefits of producing or consuming a product or service. This results in an economic inefficiency or market failure.

lower levels of provision of ground services such as airport lounges and check-in services.

3.12. The ACCC accepts that cooperation agreements can provide a means to address this externality or inefficiency by enabling airlines to coordinate across complementary segments. Typically this coordination occurs through:

- joint setting of schedules and fares/cargo charges;
- mutual recognition of value added services (frequent flyer schemes, frequent shipper schemes and airport lounges) between the airlines; and
- revenue sharing.

The applicants seek authorisation for the joint setting of schedules and fares and mutual recognition of value added services.

3.13. The ACCC considers that the applicants are likely to have an incentive under the Commercial Alliance to optimise their joint service offering and that this is likely to result in public benefits by facilitating single booking of complementary passenger and cargo services, and through check-in of baggage and cargo. It also has potential to confer public benefits through better scheduling of complementary services, improved customer disruption handling and better access to value added services (reward schemes and airport lounges).

3.14. The ACCC acknowledges that the Commercial Alliance will enable the applicants to initiate reciprocal frequent flyer programs and status recognition, which will enhance the attractiveness of both airlines' loyalty programs. Generally speaking, the ACCC considers that there are likely to be public benefits from reciprocal access to loyalty programs and that these are likely to accrue to passengers who prefer to fly with one of the applicants, are members of a loyalty program and who value the ability to earn or use frequent flyer points.

Cost savings and efficiencies

3.15. The ACCC has previously considered that aviation alliances may result in lower fares/cargo charges for customers by removing or reducing double marginalisation. Double marginalisation occurs where suppliers of complementary products independently charge a price which includes a mark-up over their costs to maximise their individual profits and do not take account of the impact of these prices on demand for the other airlines' services. The net result is higher prices/cargo charges on connecting routes than if the two firms were to coordinate their pricing, for example, through a cooperation agreement or alliance.

3.16. The ACCC considers that further efficiencies may be delivered by an aviation alliance to the extent that it facilitates cost savings and efficiencies through, for example, rationalisation of common costs, better capacity utilisation, synergies through joint marketing and investment (e.g. in IT systems) and/or lower contracting costs. The ACCC considers that some of these benefits may be realised by the applicants under the Commercial Alliance, though the extent of benefit in some cases (e.g. better capacity utilisation) depends on the additional traffic that the alliance actually stimulates. These cost savings and efficiencies may be passed through to passengers

and users of the applicants' cargo services in the form of lower fares/cargo rates or higher levels of service.

- 3.17. The ACCC considers that the Commercial Alliance may give rise to public benefits in the form of cost savings and efficiencies.

Promotion of competition

- 3.18. The ACCC notes the applicants' claim that the Commercial Alliance will enable Air Berlin to build an international network for travel to and from Australia in competition with Star Alliance carriers and Emirates. The applicants state that this will result in a public benefit, including by stimulating competition.
- 3.19. The ACCC has previously accepted that aviation alliances can stimulate competitive responses amongst rivals in the international air passenger transport services markets where the alliance enhances the alliance partners' products and results in lower fares (to the extent that the cost savings and other efficiencies are passed through to customers).
- 3.20. The ACCC notes that the Commercial Alliance will assist Etihad and Air Berlin to offer an integrated service. The ACCC considers that this has the potential to allow the applicants to better compete with rival airlines operating in the same relevant markets. In turn, it may trigger a competitive response from those rivals, resulting in public benefits such as lower prices and higher levels of service being offered in the future.

Tourism

- 3.21. The ACCC has noted previously that there are a wide range of factors which influence tourism demand and expenditure, including general purchasing power in source countries, the relative cost of other destinations, the total cost of visiting Australia and the perceived quality of Australia as a destination.
- 3.22. In this case, the ACCC considers that the Commercial Alliance has the potential to stimulate tourism in Australia if it generates increased passenger traffic to Australia. The ACCC considers that this may provide some limited benefits to Australian businesses and individuals.

Public detriments

- 3.23. Public detriment is also not defined in the Act but the Tribunal has given it a wide meaning to include:

... any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.¹⁰

- 3.24. Etihad and Air Berlin submit that the Commercial Alliance is unlikely to result in any competitive harm in any of the relevant markets as the applicants do not overlap on routes between Germany and Australia.

¹⁰ *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

- 3.25. The ACCC notes Etihad is the largest shareholder (29.21%) in Air Berlin and considers that this may give the applicants an incentive to more closely align their commercial interests with or without authorisation.
- 3.26. The ACCC also notes that the destinations serviced by Etihad and Air Berlin are largely complementary.
- 3.27. Prior to entering into the Commercial Alliance there was no overlap between the routes offered by Etihad and Air Berlin, however Air Berlin operated a route between Berlin and Dubai. Since entering into the Commercial Alliance and commencing codesharing on 29 March 2012, scheduling changes have resulted in Etihad and Air Berlin now both operating on the Abu Dhabi to Dusseldorf route, and Air Berlin moving its Berlin – Dubai service to Berlin – Abu Dhabi. There are currently no other airlines operating on these routes, although the ACCC notes that Emirates operates flights between Dubai and Dusseldorf, and Dubai and Berlin.
- 3.28. The ACCC considers that the price and service decisions of the applicants post-alliance in each the relevant passenger and cargo markets (Australia to the Middle East/South East Asia and Australia to Europe) are likely to be disciplined by the presence of other international airlines operating in those markets. These include Lufthansa, Qantas/British Airways, Singapore Airlines, Emirates, Cathay Pacific Airways, Thai Airways and others.
- 3.29. On this basis, the ACCC considers that the Commercial Alliance is likely to result in little if any public detriment.

Balance of benefits and detriments

- 3.30. In general, the ACCC may grant authorisation if it is satisfied that, in all the circumstances, the Commercial Alliance is likely to result in a public benefit, and that public benefit will outweigh any likely public detriment.
- 3.31. In the context of applying the net public benefit test in section 90(8)¹¹ of the Act, the Tribunal commented that:

... something more than a negligible benefit is required before the power to grant authorisation can be exercised.¹²

- 3.32. For the reasons outlined above the ACCC considers the Commercial Alliance is likely to result in public benefits in the form of:
- enhanced products and services; and
 - the promotion of competition.
- 3.33. The Commercial Alliance may also result in some stimulation of tourism.
- 3.34. The ACCC does not consider that the Commercial Alliance is likely to result in any significant public detriment.

- 3.35. Accordingly, the ACCC is satisfied that the public benefit that is likely to result from the conduct would outweigh the public detriment, including from any lessening of competition that may result. The ACCC is therefore satisfied that the relevant tests are met.

Length of Authorisation

- 3.36. The Act allows the ACCC to grant authorisation for a limited period of time.¹³ In this instance, Etihad and Air Berlin seek authorisation for the period of the Commercial Alliance, or alternatively, for a period of ten years.
- 3.37. As indicated above, the ACCC considers that the Commercial Alliance is likely to result in a number of public benefits, and there is unlikely to be any significant public detriment. On this basis, the ACCC proposes to grant authorisation for the Commercial Alliance for ten years.

Variations

- 3.38. The ACCC notes that any amendments to the Commercial Alliance during the proposed term of this authorisation would not be covered by the proposed authorisation.

¹³ Section 91(1).

4. Draft determination

The application

- 4.1. On 26 April 2012, Etihad and Air Berlin lodged application for authorisation A91307 & A91308 with the Australian Competition and Consumer Commission (the ACCC). The application relates to a Commercial Alliance between Etihad and Air Berlin.
- 4.2. Application A91307 was made using Form A, Schedule 1, of the Competition and Consumer Regulations 2010. The application was made under subsection 88(1A) of the Act to:
- make and give effect to a contract, arrangement or understanding, a provision of which is or may be an exclusionary provision within the meaning of section 45 of the Act.
 - make and give effect to a provision of a contact, arrangement or understanding, a provision of which is, or may be, a cartel provision and which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act.
- 4.3. Application A91308 was made using Form B, Schedule 1, of the Competition and Consumer Regulations 2010. The application was made under subsections 88(1A) and 88(1) of the Act to:
- make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act.
 - make and give effect to a contract or arrangement, or arrive at an understanding a provision of which would be, or might be, a cartel provision (other than a provision which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act).
- 4.4. Section 90A(1) requires that before determining an application for authorisation the ACCC shall prepare a draft determination.

The net public benefit test

- 4.5. For the reasons outlined in this draft determination, the ACCC considers that in all the circumstances the conduct for which authorisation is sought are likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the conduct.¹⁴

¹⁴ The relevant tests are set out in Sections 90(5A),(5B),(6) and (7) of the Act.

- 4.6. The ACCC is also satisfied that the conduct for which authorisation is sought are likely to result in such a benefit to the public that the conduct should be allowed to take place.¹⁵
- 4.7. The ACCC therefore **proposes to grant** authorisation to applications A91307 & A91308.

Conduct for which the ACCC proposes to grant authorisation

- 4.8. The ACCC proposes to grant authorisation for a Commercial Alliance between Etihad and Air Berlin for ten years.
- 4.9. Further, the proposed authorisation is in respect of the Commercial Alliance as it stands at the time authorisation is granted. Any changes to the Commercial Alliance during the term of the proposed authorisation would not be covered by the proposed authorisation.
- 4.10. This draft determination is made on 27 June 2012.

Interim authorisation

- 4.11. At the time of lodging the application, Etihad and Air Berlin requested interim authorisation to commence the Commercial Alliance. The ACCC granted interim authorisation on 16 May 2012.
- 4.12. Interim authorisation will remain in place until the date the ACCC's final determination comes into effect or until the ACCC decides to revoke interim authorisation.

Further submissions

- 4.13. The ACCC will now seek further submissions from interested parties. In addition, the applicant or any interested party may request that the ACCC hold a conference to discuss the draft determination, pursuant to section 90A of the Act.

¹⁵ The relevant test is set out in Section 90(8) of the Act.