Australian Competition & Consumer Commission

Draft Determination

Application/s for authorisation

lodged by

Emirates and Flydubai

in respect of

an Affiliation Agreement

Date: 27 June 2012

Authorisation no.: A91298 & A91299

Public Register no.: C2012/302

Commissioners: Schaper
Rickard
Dimasi
Walker
Willett

Summary

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The ACCC proposes to grant authorisation for ten years to Emirates and Flydubai to make, and give effect to, their Affiliation Agreement. Under the Affiliation Agreement the applicants will coordinate on international air passenger transport and international air cargo transportation services between Australia and the Middle East and Australia and regions adjacent the Middle East (North West Africa, Indian sub-continent, Eastern Europe).

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 23 April 2012, Emirates and the Dubai Aviation Corporation (Flydubai) (together ‘the applicants’) lodged authorisation applications A91298 & A91299 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. Emirates is a government decree Dubai corporation established by Decree No.2 of 1985. Emirates is wholly owned by the Investment Corporation of Dubai, which is in turn wholly owned by the Government of Dubai. Emirates is a full service carrier that operates international air passenger transport and air cargo services. Emirates operates a fleet of long-haul wide body aircraft, and flies to over 100 destinations, in 70 countries across six continents. Emirates operates direct long-haul services between Dubai and Melbourne, Sydney, Brisbane and Perth. Emirates also offers indirect services between Dubai and Australia via Singapore, Kuala Lumpur and Bangkok. In addition Emirates also operates on some trans-Tasman routes (Brisbane/Melbourne/Sydney – Auckland and Sydney-Christchurch).

1.3. Flydubai is the trading name of Dubai Aviation Corporation, which is a government decree Dubai corporation established by Decree No.11 of 2008. Flydubai is owned outright by the Government of Dubai. Flydubai is a low cost carrier that operates international air passenger transport and air cargo services. Flydubai operates a fleet of narrow body aircraft that are unsuitable for long haul operations. Its aircraft fleet cannot fly non-stop distances greater than 5,500km. Flydubai operates flights between Dubai and destinations in the Middle East and adjacent regions (Northern Africa, Indian subcontinent, Eastern Europe). Flydubai does not currently operate any flights to or from Australia.

1.4. Emirates and Flydubai have already entered into a Special Pro-rate Agreement (SPA) which provides for two-way interlining[1] of air passenger and air cargo transport services, when it is technically feasible. Under this agreement each airline pays the other revenue on a pro-rata basis depending on the section of the route operated by the respective carrier.[2]

1.5. The applicants seek authorisation to implement an Affiliation Agreement, which represents a substantially deeper level of coordination and integration between the applicants than is afforded under the SPA. Under the Affiliation Agreement the applicants will coordinate on international passenger transportation and air cargo transportation services between Australia and Dubai and on 'behind and beyond' services.[3] The cooperation contemplated under the Affiliation Agreement includes:

- marketing and advertising arrangements;
- interline, SPA and codeshare arrangements;[4]
- pricing strategies;
- revenue sharing; [5]
- frequent flyer rewards programmes;
- flight schedules and airport handling services;
- joint purchase of goods and services from third party suppliers and vendors;
- sharing of information and facilities;
- staff secondments;
- making joint submissions to IATA; and
- other joint and coordinated activities, including holiday/vacation packages; customer rebates; corporate dealings and incentives and discounts.

2. Submissions received by the ACCC

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

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[1] Interlining involves the carriage of passengers and/or cargo between two points using more than one airline under an arrangement which typically involves baggage check-through and the honouring of tickets between airlines.
[2] For example, if a passenger purchases a fare with Emirates for a journey where separate sections of the route are operated by each of Emirates and Flydubai, Flydubai receives a portion of the fare pro-rated to the section operated by Flydubai.
[3] Behind and beyond refers to complementary segments behind the origin of a flight, and beyond the destination. For example a route between Sydney and Dubai may have Auckland as a behind route and European destinations as beyond routes.
[4] Code sharing refers to arrangements involving the assignment of one airline's designator code to a flight operated by another airline.
[5] The applicants state that revenue sharing will involve revenue allocation from codeshare flights and other flights, interline, special prorate, and block space agreements, including, if mutually agreed, the pooling or sharing of revenue and/or costs and optimising pricing opportunities.

3. ACCC Evaluation

3.1. The ACCC's evaluation of the proposed Affiliation Agreement is in accordance with the relevant net public benefit tests[6] 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, 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 and (ii) Australia and regions adjacent the Middle East (North West Africa, Indian sub-continent, Eastern Europe); and

- international air cargo transport services between (i) Australia and the Middle East; and (ii) Australia and regions adjacent the Middle East (North West Africa, Indian sub-continent, Eastern Europe).

3.3. 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 and adjacent regions, including via intermediate points outside these regions.

3.4. The ACCC considers that, while there may be separate international air passenger transport service markets for leisure and business passengers and for direct and indirect (one or more stop) services, the outcome of the competition assessment in this matter is not impacted by such distinctions.

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.

3.7. The ACCC considers that without authorisation:

- Emirates would continue to operate long-haul direct and indirect flights to/from Australia;

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[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.

- Flydubai would continue to operate short haul passenger and cargo services out of Dubai. Accordingly, it would not operate any direct flights between the Middle East and Australia;
- It is unlikely that the applicants would be close competitors due to their common ownership; and
- The existing SPA between the two airlines would continue.

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 Affiliation Agreement they will be able to offer:

- Enhanced network coverage and service offerings through:
  - more single booking destinations[9]; and
  - improvement to the standard of cargo services offered and increase in the number of cargo destinations.
- the provision of a wide range of enhanced customer products and services;
- cost savings and efficiencies;
- the promotion of competition and lower connecting fares;
- increased opportunities for international trade and Australian corporations that do business in the network in which Flydubai operates; and
- stimulation of Australian tourism.

3.10. The ACCC's assessment of the likely public benefit of the Affiliation Agreement 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

[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] Single booking destinations refer to being able to book a flight using the services of multiple airlines with one ticket. For example a passenger wishing to travel from Sydney to Kiev currently has to book a ticket from Sydney to Dubai with Emirates, and a ticket from Dubai to Kiev with Flydubai. A single booking destination would allow a passenger to book a ticket from Sydney to Kiev.

consequence of this ‘externality’[10] can include less convenient connections for passengers, higher fares/cargo charges, less attractive customer reward programs and/or 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;
- revenue sharing; and
- mutual recognition of value added services (frequent flyer schemes, frequent shipper schemes and airport lounges) between the airlines.

The applicants seek authorisation for all these forms of coordination.

3.13. The ACCC considers that the applicants are likely to have an incentive under the Affiliation Agreement 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).

Cost savings and efficiencies

3.14. The ACCC considers that the Affiliation Agreement may result in lower fares/cargo charges for customers by removing or reducing double marginalisation. Double marginalisation occurs where suppliers of complementary products, such as Emirates and Flydubai, 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 such as the Affiliation Agreement.

3.15. The ACCC accepts 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 several of these benefits may be realised by the applicants under the Affiliation Agreement, 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.

[10] 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.

3.16. The ACCC therefore accepts that the Affiliation Agreement is likely to give rise to public benefits in the form of cost savings and efficiencies.

Promoting competition

3.17. The ACCC notes the applicants' claim that the enhanced product and service offering under the Affiliation Agreement will encourage a competitive response from existing competitors resulting in lower connecting fares.

3.18. 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' passenger service offering and/or results in lower fares.

3.19. The ACCC also considers that aviation alliances may stimulate competitive responses from rival air cargo service providers, to the extent that the alliance enhances the cargo service and/or reduces the cargo rates.

3.20. The ACCC notes that the Affiliation Agreement will assist Emirates and Flydubai to offer an integrated service. The ACCC considers that this has the potential to trigger a competitive response from rivals operating in the same relevant markets, resulting in further public benefits to passengers and users of cargo services such as lower prices and higher levels of service being offered to customers in the future.

Tourism and Trade

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. Notwithstanding this the ACCC has recognised the potential for airline alliances to increase tourism demand and expenditure in some cases.

3.22. The ACCC also notes that there are a large number of factors which are likely to affect the volume and value of trade between Australia and the Middle East (and behind and beyond destinations) and that airline alliances may increase trade opportunities for Australia.

3.23. In this case, the ACCC considers that the Affiliation Agreement has the potential to bring about some, likely very limited, increase in tourism and trade for Australia to the extent that it generates increased passenger and cargo traffic between Australia and the Middle East and surrounding regions. The ACCC considers that this may provide some limited benefit to Australian businesses and individuals.

Public detriments

3.24. 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.[11]

3.25. Emirates and Flydubai submit that the Affiliation Agreement is unlikely to result in any competitive harm in any of the relevant markets as the applicants offer largely complementary services, both in terms of products and in routes covered.

3.26. The ACCC notes that the products and routes serviced by Emirates and Flydubai are largely complementary. The applicants differentiate their product and service offering by aircraft type, level of service and (to a great extent) destinations served. The applicants submit that Flydubai's low cost carrier model principally targets leisure travellers, while Emirates caters more readily to business travellers.

3.27. Emirates and Flydubai offer overlapping services on 19 of the 160 destinations currently served by their networks. These 19 routes are between Dubai and destinations in the Middle East, North West Africa, and the Indian sub-continent. However, the ACCC considers it is unlikely that the applicants are close competitors on these overlap routes in view of:

(i) their common ownership;

(ii) their different product offering and cost structures (Emirates being a long haul, full service carrier and FlyDubai being a short-haul low cost carrier); and

(iii) the degree of cooperation between the applicants under the current SPA (which exists with or without the Affiliation Agreement).

3.28. The ACCC also notes that, with one exception, there is at least one competitor offering a direct air passenger service on each of these overlap routes.[12] In the majority of instances there are three or more competitors offering a direct passenger service in addition to Emirates and Flydubai operating on these routes. The ACCC accepts that these airlines are likely to be a source of competitive constraint on the applicants' international air passenger transport services on overlapping routes post-alliance.

3.29. The ACCC agrees with the applicants that a number of international airlines provide air cargo transport services in the relevant air cargo market, including most if not all international passenger airlines (which carry belly hold cargo) and a number of dedicated air freighters. The ACCC considers that there a number of indirect air cargo services may also constrain the applicants' air cargo price and service offering on overlapping routes post-alliance.

3.30. On this basis, the ACCC considers that the Affiliation Agreement is likely to result in little if any public detriment.

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

[12] Only Emirates and Flydubai operate direct flights between Ahmadabad, India and Dubai. There are five airlines that operate indirect flights between these destinations including Air India and Jet Airways India.

Balance of benefits and detriments

3.31. In general, the ACCC may grant authorisation if it is satisfied that, in all the circumstances, the Affiliation Agreement is likely to result in a public benefit, and that public benefit will outweigh any likely public detriment.

3.32. In the context of applying the net public benefit test in section 90(8)[13] of the Act, the Tribunal commented that:

> … something more than a negligible benefit is required before the power to grant authorisation can be exercised.[14]

3.33. For the reasons outlined above the ACCC considers that the Affiliation Agreement is likely to result in public benefits in the form of:

- improved products and services; and
- cost savings and efficiencies.

3.34. The Affiliation Agreement may also result in some stimulation of tourism and trade and may promote competition between rival airlines in the relevant markets.

3.35. The ACCC does not consider that the Affiliation Agreement is likely to result in significant public detriment in any relevant market.

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

Length of Authorisation

3.37. The Act allows the ACCC to grant authorisation for a limited period of time.[15]

3.38. In this instance, Emirates and Flydubai seek authorisation for ten years. The applicants submit that this period reflects the negligible detriment associated with the proposed Affiliation Agreement, and the significant public benefits that will be achieved.

3.39. The ACCC did not receive any interested party submissions in relation to the length of authorisation sought.

3.40. As indicated, the ACCC considers that the Affiliation Agreement 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 Affiliation Agreement for ten years.

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[13] The test at 90(8) of the Act is in essence that conduct is likely to result in such a benefit to the public that it should be allowed to take place.

[14] *Re Application by Michael Jools, President of the NSW Taxi Drivers Association* [2006] ACompT 5 at paragraph 22.

[15] Section 91(1).

Variations

3.41. The ACCC notes that any amendments to the Affiliation Agreement during the proposed term of this authorisation would not be covered by the proposed authorisation.

4. Draft determination

The application

4.1. On 23 April 2012, Emirates and Flydubai lodged application for authorisation A91298 & A91299 with the Australian Competition and Consumer Commission (the ACCC). The applications relate to an Affiliation Agreement between Emirates and Flydubai.

4.2. Application A91298 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 A91299 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 is 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.[16]

[16] 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.[17]

4.7. The ACCC therefore **proposes to grant** authorisation to applications A91298 & A91299.

Conduct for which the ACCC proposes to grant authorisation

4.8. The ACCC proposes to grant authorisation for an Affiliation Agreement between Emirates and Flydubai for ten years.

4.9. Further, the proposed authorisation is in respect of the Affiliation Agreement as it stands at the time authorisation is granted. Any changes to the Affiliation Agreement 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, Emirates and Flydubai requested interim authorisation to commence the Affiliation Agreement. 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.

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