

General Counsel
Andrew Finch



18 November 2014

Dr Richard Chadwick
General Manager, Adjudication Branch
Enforcement and Compliance Division
Australian Competition & Consumer Commission
23 Marcus Clarke Street
Canberra ACT 2601

Dear Richard

Proposed Cooperation between Qantas and China Eastern – Applications for Authorisation

Thank you for your time today.

Qantas Airways Limited (**Qantas**) and China Eastern Airlines Corporation Limited (**China Eastern**) and their related bodies corporate (together the **Applicants**) apply for authorisation pursuant to section 88(1A) and 88(1) of the *Competition and Consumer Act 2010* (Cth) (the **Act**) in relation to a Joint Coordination Agreement under which they would coordinate their operations between Australia and China (**Proposed Conduct**).

We enclose:

- Application Forms A and B;
- a confidential supporting submission to the ACCC (**Confidential Submission**); and
- a redacted public register version of the supporting submission to the ACCC (**Public Submission**).

The appropriate filing fee of \$9,000 will be paid this afternoon.

We request that the enclosed Confidential Submission be excluded from the Commission's Public Register on the basis that this version of the submission contains information that is commercially confidential to Qantas and China Eastern. The disclosure of this information would unreasonably and adversely affect Qantas and China Eastern in respect of their lawful business, commercial and financial affairs. We request that only the Public Submission be placed on the Public Register.

Please contact me or Anna Pritchard on 02 9691 5515 if you would like to discuss this letter or the enclosed submission.

Yours sincerely

Andrew Finch
General Counsel

Form A

Commonwealth of Australia

Competition and Consumer Act 2010 — subsections 88 (1A) and (1)

EXCLUSIONARY PROVISIONS AND ASSOCIATED CARTEL PROVISIONS: APPLICATION FOR AUTHORISATION

To the Australian Competition and Consumer Commission:

Application is hereby made under subsection(s) 88 (1A)/88 (1) of the *Competition and Consumer Act 2010* for an authorisation:

- to give effect to a provision of a contract, arrangement or understanding that is, or may be, a cartel provision within the meaning of Division 1 of Part IV of that Act and which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act.
- to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of section 45 of that Act.

1. Applicant

(a) **Name of Applicant:**

Qantas Airways Limited (**Qantas**) (ABN 16 009 661 901); and

China Eastern Airlines Corporation Limited (**China Eastern**) (ABN 18 075 465 575).

This application is to be read and determined together with the application in Form B (together the **Application**) and the submission supporting the Application (the **Submission**), which are lodged with this form.

(b) **Description of business carried on by applicant:**

The provision of domestic and international air transportation services.

For more detail please refer to the Submission.

(c) **Address in Australia for service of documents on the applicant:**

Qantas

Qantas Airways Limited

10 Bourke Road

Mascot NSW 2020

Attention: Anna Pritchard

Tel: 02 9691 5515

Fax: 02 9691 5417

annapritchard@qantas.com.au

A91470

China Eastern

China Eastern Airlines Corporation Limited

2550 Hong Qiao Road

Shanghai, 200335, P.R.China

Attention: Tao Zhen

Tel: +86 21 2233 0279

Fax: +86 21 6269 1001

ztao@ceair.com

2. Contract, arrangement or understanding

(a) Description of the contract, arrangement or understanding, whether proposed or actual, for which authorisation is sought:

Qantas and China Eastern and their related bodies corporate seek authorisation from the Commission to coordinate their operations between Australia and China (**Proposed Conduct**) pursuant to a Joint Coordination Agreement (**Joint Coordination Agreement**). A copy of the Joint Coordination Agreement forms Confidential Annexure A to the Submission.

(b) Description of those provisions of the contract, arrangement or understanding described at 2 (a) that are, or would or might be, exclusionary provisions and (if applicable) are, or would or might be, cartel provisions:

See the Submission and Confidential Annexure A to the Submission.

(c) Description of the goods or services to which the contract, arrangement or understanding (whether proposed or actual) relate:

Commercial passenger airline services and air freight services.

(d) The term for which authorisation of the provision of the contract, arrangement or understanding (whether proposed or actual) is being sought and grounds supporting this period of authorisation:

Authorisation of the Proposed Conduct is sought for the term of the Joint Coordination Agreement, a period of five years. The grounds supporting this period of authorisation are set out in the Submission.

3. Parties to the proposed arrangement

(a) Names, addresses and descriptions of business carried on by other parties or proposed parties to the contract or proposed contract, arrangement or understanding:

Not applicable.

(b) Names, addresses and descriptions of business carried on by parties and other persons on whose behalf this application is made:

Not applicable.

4. Public benefit claims

(a) Arguments in support of application for authorisation:

See the Submission.

(b) Facts and evidence relied upon in support of these claims:

See the Submission.

5. Market definition

Provide a description of the market(s) in which the goods or services described at 2 (c) are supplied or acquired and other affected markets including: significant suppliers and acquirers; substitutes available for the relevant goods or services; any restriction on the supply or acquisition of the relevant goods or services (for example geographic or legal restrictions):

See the Submission.

6. Public detriments

(a) Detriments to the public resulting or likely to result from the contract arrangement or understanding for which authorisation is sought, in particular the likely effect of the contract arrangement or understanding, on the prices of the goods or services described at 2 (c) and the prices of goods or services in other affected markets:

See the Submission.

(b) Facts and evidence relevant to these detriments:

See the Submission.

7. Contracts, arrangements or understandings in similar terms

(a) This application for authorisation may also be expressed to be made in relation to other contracts, arrangements or understandings or proposed contracts, arrangements or understandings, that are or will be in similar terms to the abovementioned contract, arrangement or understanding:

(b) Is this application to be so expressed?

No.

(c) If so, the following information is to be furnished:

(i) Description of any variations between the contract, arrangement or understanding for which authorisation is sought and those contracts, arrangements or understandings that are stated to be in similar terms:

Not applicable.

(ii) Where the parties to the similar term contract(s) are known — names, addresses and descriptions of business carried on by those other parties:

Not applicable.

- (iii) **Where the parties to the similar term contract(s) are not known — description of the class of business carried on by those possible parties:**

Not applicable.

8. Joint Ventures

- (a) **Does this application deal with a matter relating to a joint venture (See section 4J of the Competition and Consumer Act 2010)?**

Yes.

- (b) **If so, are any other applications being made simultaneously with this application in relation to that joint venture?**

Yes, the attached Form B.

- (c) **If so, by whom or on whose behalf are those other applications being made?**

Qantas and China Eastern.

9. Further information

- (a) **Name, postal address and telephone contact details of the person authorised by the applicant seeking authorisation to provide additional information in relation to this application:**

Qantas

Qantas Airways Limited
10 Bourke Road
Mascot NSW 2020

Attention: Anna Pritchard
Tel: 02 9691 5515
Fax: 02 9691 5417
annapritchard@qantas.com.au

China Eastern

China Eastern Airlines Corporation Limited
2550 Hong Qiao Road
Shanghai, 200335, P.R.China

Attention: Tao Zhen
Tel: +86 21 2233 0279
Fax: +86 21 6269 1001
ztao@ceair.com

Dated 18 November 2014

Signed by/on behalf of Qantas Airways Limited



Andrew Finch
Qantas Airways
General Counsel and Company Secretary

Signed by/on behalf of China Eastern



(Signature)

GUO LIJUN

(Full Name)

General Counsel of China Eastern Airlines Co., Ltd.
(Position in Organisation)

DIRECTIONS

1. Use Form A if the contract, arrangement or understanding includes a provision which is, or might be, a cartel provision and which is also, or might also be, an exclusionary provision. Use Form B if the contract, arrangement or understanding includes a provision which is, or might be, a cartel provision or a provision which would have the purpose, or would or might have the effect, of substantially lessening competition. It may be necessary to use both forms for the same contract, arrangement or understanding.

In lodging this form, applicants must include all information, including supporting evidence, that they wish the Commission to take into account in assessing their application for authorisation.

Where there is insufficient space on this form to furnish the required information, the information is to be shown on separate sheets, numbered consecutively and signed by or on behalf of the applicant.

2. Where the application is made by or on behalf of a corporation, the name of the corporation is to be inserted in item 1 (a), not the name of the person signing the application and the application is to be signed by a person authorised by the corporation to do so.
3. Describe that part of the applicant's business relating to the subject matter of the contract, arrangement or understanding in respect of which authorisation is sought.
4. Provide details of the contract, arrangement or understanding (whether proposed or actual) in respect of which the authorisation is sought. Provide details of those provisions of the contract, arrangement or understanding that are, or would or might be, exclusionary provisions. Provide details of those provisions of the contract, arrangement or understanding that are, or would or might be, cartel provisions.

In providing these details:

- (a) to the extent that any of the details have been reduced to writing, provide a true copy of the writing; and
 - (b) to the extent that any of the details have not been reduced to writing, provide a full and correct description of the particulars that have not been reduced to writing.
5. Where authorisation is sought on behalf of other parties provide details of each of those parties including names, addresses, descriptions of the business activities engaged in relating to the subject matter of the authorisation, and evidence of the party's consent to authorisation being sought on their behalf.
 6. Provide details of those public benefits claimed to result or to be likely to result from the proposed contract, arrangement or understanding including quantification of those benefits where possible.
 7. Provide details of the market(s) likely to be effected by the contract, arrangement or understanding in particular having regard to goods or services that may be substitutes for the good or service that is the subject matter of the application for authorisation.

8. Provide details of the detriments to the public, including those resulting from any lessening of competition, which may result from the proposed contract, arrangement or understanding. Provide quantification of those detriments where possible.
9. Where the application is made also in respect of other contracts, arrangements or understandings, which are or will be in similar terms to the contract, arrangement or understanding referred to in item 2, furnish with the application details of the manner in which those contracts, arrangements or understandings vary in their terms from the contract, arrangements or understanding referred to in item 2.
10. Where authorisation is sought on behalf of other parties provide details of each of those parties including names, addresses, and descriptions of the business activities engaged in relating to the subject matter of the authorisation, and evidence of the party's consent to authorisation being sought on their behalf.

Form B

Commonwealth of Australia

Competition and Consumer Act 2010 — subsections 88 (1A) and (1)

AGREEMENTS AFFECTING COMPETITION OR INCORPORATING RELATED CARTEL PROVISIONS: APPLICATION FOR AUTHORISATION

To the Australian Competition and Consumer Commission:

Application is hereby made under subsection(s) 88 (1A)/88 (1) of the *Competition and Consumer Act 2010* for an authorisation:

- to give effect to a provision of a contract, arrangement or understanding that is, or may be, a cartel provision within the meaning of Division 1 of Part IV of that Act (other than a provision which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act).
- to give effect to a provision of a contract, arrangement or understanding which provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of that Act.

1. Applicant

(a) Name of Applicant:

Qantas Airways Limited (**Qantas**) (ABN 16 009 661 901); and

China Eastern Airlines Corporation Limited (**China Eastern**) (ABN 18 075 465 575).

This application is to be read and determined together with the application in Form A (together the **Application**) and the submission supporting the Application (the **Submission**), which are lodged with this form.

(b) Short description of business carried on by applicant:

The provision of domestic and international air transportation services.

For more detail please refer to the Submission.

(c) Address in Australia for service of documents on the applicant:

Qantas

Qantas Airways Limited

10 Bourke Road

Mascot NSW 2020

Attention: Anna Pritchard

Tel: 02 9691 5515

Fax: 02 9691 5417

annapritchard@qantas.com.au

A91471

China Eastern

China Eastern Airlines Corporation Limited

2550 Hong Qiao Road

Shanghai, 200335, P.R.China

Attention: Tao Zhen

Tel: +86 21 2233 0279

Fax: +86 21 6269 1001

ztao@ceair.com

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(a) Description of the contract, arrangement or understanding, whether proposed or actual, for which authorisation is sought:

Qantas and China Eastern and their related bodes corporate seek authorisation from the Commission to coordinate their operations between Australia and China (**Proposed Conduct**) pursuant to a Joint Coordination Agreement (**Joint Coordination Agreement**). A copy of the Coordination Agreement forms Confidential Annexure A to the Submission.

(b) Description of those provisions of the contract, arrangement or understanding described at 2 (a) that are, or would or might be, cartel provisions, or that do, or would or might, have the effect of substantially lessening competition:

See the Submission and Confidential Annexure A to the Submission.

(c) Description of the goods or services to which the contract, arrangement or understanding (whether proposed or actual) relate:

Commercial passenger airline services and air freight services.

(d) The term for which authorisation of the contract, arrangement or understanding (whether proposed or actual) is being sought and grounds supporting this period of authorisation:

Authorisation of the Proposed Conduct is sought for the term of the Joint Coordination Agreement, a period of five years. The grounds supporting this period of authorisation are set out in the Submission.

3. Parties to the proposed arrangement

(a) Names, addresses and descriptions of business carried on by other parties or proposed parties to the contract or proposed contract, arrangement or understanding:

Not applicable.

(b) Names, addresses and descriptions of business carried on by parties and other persons on whose behalf this application is made:

Not applicable.

4. Public benefit claims

(a) Arguments in support of authorisation:

See the Submission.

(b) Facts and evidence relied upon in support of these claims:

See the Submission.

5. Market definition

Provide a description of the market(s) in which the goods or services described at 2 (c) are supplied or acquired and other affected markets including: significant suppliers and acquirers; substitutes available for the relevant goods or services; any restriction on the supply or acquisition of the relevant goods or services (for example geographic or legal restrictions):

See the Submission.

6. Public detriments

(a) Detriments to the public resulting or likely to result from the authorisation, in particular the likely effect of the contract, arrangement or understanding, on the prices of the goods or services described at 2 (c) and the prices of goods or services in other affected markets:

See the Submission.

(b) Facts and evidence relevant to these detriments:

See the Submission.

7. Contract, arrangements or understandings in similar terms

This application for authorisation may also be expressed to be made in relation to other contracts, arrangements or understandings or proposed contracts, arrangements or understandings, that are or will be in similar terms to the abovementioned contract, arrangement or understanding.

(a) Is this application to be so expressed?

No.

(b) If so, the following information is to be furnished:

(i) description of any variations between the contract, arrangement or understanding for which authorisation is sought and those contracts, arrangements or understandings that are stated to be in similar terms:

Not applicable.

(ii) Where the parties to the similar term contract(s) are known — names, addresses and descriptions of business carried on by those other parties:

Not applicable.

- (iii) **Where the parties to the similar term contract(s) are not known — description of the class of business carried on by those possible parties:**

Not applicable.

8. Joint Ventures

- (a) **Does this application deal with a matter relating to a joint venture (See section 4J of the Competition and Consumer Act 2010)?**

Yes.

- (b) **If so, are any other applications being made simultaneously with this application in relation to that joint venture?**

Yes, the attached Form A.

- (c) **If so, by whom or on whose behalf are those other applications being made?**

Qantas and China Eastern.

9. Further information

- (a) **Name and address of person authorised by the applicant to provide additional information in relation to this application:**

Qantas

Qantas Airways Limited
10 Bourke Road
Mascot NSW 2020

Attention: Anna Pritchard
Tel: 02 9691 5515
Fax: 02 9691 5417
annapritchard@qantas.com.au

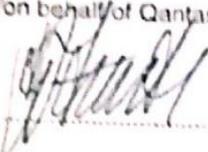
China Eastern

China Eastern Airlines Corporation Limited
2550 Hong Qiao Road
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Attention: Tao Zhen
Tel: +86 21 2233 0279
Fax: +86 21 6269 1001
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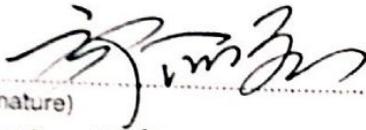
Dated 18 November 2014

Signed by/on behalf of Qantas Airways Limited



Andrew Finch
Qantas Airways
General Counsel and Company Secretary

Signed by/on behalf of China Eastern



(Signature)

GUO LIJUN

(Full Name)

China Eastern Airlines Co, Ltd.

(Organisation)

General Counsel

(Position in organisation)

DIRECTIONS

1. Use Form A if the contract, arrangement or understanding includes a provision which is, or might be, a cartel provision and which is also, or might also be, an exclusionary provision. Use Form B if the contract, arrangement or understanding includes a provision which is, or might be, a cartel provision or a provision which would have the purpose, or would or might have the effect, of substantially lessening competition. It may be necessary to use both forms for the same contract, arrangement or understanding.

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3. Describe that part of the applicant's business relating to the subject matter of the contract, arrangement or understanding in respect of which the application is made.
4. Provide details of the contract, arrangement or understanding (whether proposed or actual) in respect of which the authorisation is sought. Provide details of those provisions of the contract, arrangement or understanding that are, or would or might be, cartel provisions. Provide details of those provisions of the contract, arrangement or understanding that do, or would or might, substantially lessen competition.

In providing these details:

- (a) to the extent that any of the details have been reduced to writing, provide a true copy of the writing; and
 - (b) to the extent that any of the details have not been reduced to writing, provide a full and correct description of the particulars that have not been reduced to writing.
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 6. Provide details of those public benefits claimed to result or to be likely to result from the proposed contract, arrangement or understanding including quantification of those benefits where possible.
 7. Provide details of the market(s) likely to be effected by the contract, arrangement or understanding, in particular having regard to goods or services that may be substitutes for the good or service that is the subject matter of the authorisation.

8. Provide details of the detriments to the public which may result from the proposed contract, arrangement or understanding including quantification of those detriments where possible.
9. Where the application is made also in respect of other contracts, arrangements or understandings, which are or will be in similar terms to the contract, arrangement or understanding referred to in item 2, furnish with the application details of the manner in which those contracts, arrangements or understandings vary in their terms from the contract, arrangements or understanding referred to in item 2.

Applications for Authorisation



中國東方航空
CHINA EASTERN



**Qantas Airways Limited
(ABN 16 009 661 901)**

and

**China Eastern Airlines Corporation Limited
(ABN 18 075 465 575)**

Joint Coordination Agreement

**Submission to the
Australian Competition & Consumer Commission**

18 November 2014

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1 EXECUTIVE SUMMARY

Qantas Airways Limited (**Qantas**) and China Eastern Airlines Corporation Limited (**China Eastern**) and their related bodies corporate (together, the **Applicants**) seek authorisation from the Australian Competition and Consumer Commission (**Commission**) to coordinate their operations between Australia and China (**Proposed Conduct**) pursuant to a Joint Coordination Agreement (**Joint Coordination Agreement**).¹

Qantas and China Eastern entered into a codeshare agreement in July 2008 (**Current Codeshare Agreement**). The Current Codeshare Agreement, as subsequently amended from time to time, allows Qantas to codeshare on China Eastern's services between each of Melbourne and Shanghai, Sydney and Beijing (via Nanjing) and Singapore and Shanghai, as well as on various services within mainland China. China Eastern codeshares on Qantas' services between Sydney and Shanghai and between Singapore and Shanghai, as well as on Qantas services to New Zealand and within domestic Australia. The Proposed Conduct seeks to move beyond the current relationship towards a new level of joint cooperation between the Applicants across many aspects of their respective businesses.

The Australia-China passenger air services market is experiencing significant growth at an average rate of 11% during the four years to April 2014.² Air services between Australia and China are a critical element in the context of the ongoing development of strong economic ties between the countries. China is now Australia's largest two-way trading partner in goods and services (valued at more than A\$150 billion in 2013), our largest goods export destination (A\$95 billion in 2013) and our largest source of merchandise imports (A\$47 billion in 2013).³ China is Australia's most valuable inbound tourism market – in 2010, the China inbound market contributed \$3.26 billion to the Australian economy; by 2020, this market has the potential to contribute \$7 to \$9 billion annually.⁴

However, neither Applicant can effectively and efficiently serve the Australia-China market alone. Qantas needs a Chinese partner to most effectively provide a seamless customer proposition throughout China and to better align its product offering to demand characteristics. Despite the market experiencing rapid and significant growth, Qantas' share of traffic has declined.⁵ Without access to sufficient capital to profitably expand its own operations, Qantas needs to collaborate with a local partner in order to leverage network benefits and distribution strength and better align its product to the predominantly leisure-oriented passenger base.

China Eastern needs an Australian partner to provide enhanced sales and distribution capability within Australia, as well as additional product and service expertise, in order to attract and retain increased numbers of passengers and to provide better services and experiences to its passengers. The Proposed Conduct will therefore bring together two complementary networks and business models – while retaining brand, product and pricing differences – and will thereby not only preserve, but also enhance, existing consumer choice.

The Proposed Conduct will have limited public detriment. There is limited operational and selling overlap between Qantas and China Eastern. Of all the routes between Australia and China, the Applicants only overlap in respect of operations on one route – that between Sydney and Shanghai. The Applicants will continue to remain constrained by China Southern, Air China, Sichuan Airlines and indirect operators such as Cathay Pacific and Singapore Airlines, all of whom are aggressive and effective competitors on services between Australia and China. In addition, the Applicants will be constrained by the threat of potential expansion by those existing competitors as well as new entrants.

¹ See Confidential Annexure A.

² Australian Bureau of Statistics data set out in Table 1 in Annexure E.

³ Department of Foreign Affairs and Trade Country Brief (Accessed 29 July 2014). Available: http://dfat.gov.au/geo/china/china_brief.html

⁴ See Tourism Australia Strategic Plan (Accessed 30 July 2014) Available: http://www.tourism.australia.com/documents/Markets/China2020_Strategic_Plan.pdf

⁵ See Australian Bureau of Statistics data set out in Table 2 in Annexure F.

The Proposed Conduct will result in substantial benefits for Australian consumers. A key benefit will be terminal co-location in Shanghai. This will significantly reduce transit times, improve connectivity and provide a genuine competitive alternative for passengers. Specifically, the Proposed Conduct will:

- a) deliver shorter journey times, improved connectivity and increased schedule choice for passengers flying from Australia to destinations within China, as a result of reduced transit times in Shanghai;
- b) result in improved products and services for customers travelling through Shanghai as a result of improved lounge facilities and coordinated customer service;
- c) facilitate capacity increases through aircraft up-gauging and increased frequencies and provide the basis for exploring opportunities to introduce new direct services between Australia and China (namely between Brisbane and/or Perth and Shanghai);
- d) provide enhanced benefits for members of both Applicants' frequent flyer programs, particularly through increased earning and redemption opportunities;
- e) lead to improved reciprocal inventory access and inventory management, leading to a greater availability and variety of price points for consumers;
- f) elicit a pro-competitive response from rival carriers, in particular China Southern and Sichuan Airlines, as well as from hubs competing with Shanghai to attract Australian transit passengers;
- g) promote increased tourism in Australia, increased employment in Australia and enhanced international trade opportunities for Australian businesses; and
- h) expedite the growth of China Eastern in Australia, leading to further employment in Australia and other economic benefits.

Such benefits will not be achievable in the counterfactual position, in which the status quo (being the limited codeshare relationship) is maintained. For example, without the Proposed Conduct, the Applicants have no commercial incentive to co-locate terminals in Shanghai nor to provide enhanced reciprocal frequent flyer benefits.

The counterfactual position is more likely to lead to the increased marginalisation of Qantas on the Australia-China market. Qantas' presence on the Australia-China market is declining. Alone, Qantas would not be able to keep pace with the capacity growth being driven by carriers such as China Southern and Sichuan Airlines, nor would Qantas be able to offer a product proposition aligned with the principally leisure-oriented passenger base. Furthermore, the counterfactual position will make it impossible for China Eastern to work with Qantas management and utilise its sales force in Australia, extend its network or provide better customer services.

The Applicants seek to implement the Proposed Conduct in June 2015 to ensure that the resultant benefits are available to the public before the start of Northern Winter 2015. Given that only limited competitive detriment will result from the Proposed Conduct yet real and substantial public benefits will be generated compared to the counterfactual, the Applicants seek authorisation of the Proposed Conduct for 5 years.

2 THE APPLICANTS

2.1 Qantas

Qantas was incorporated in Queensland, Australia in 1920 and is Australia's largest domestic and international airline. The Qantas Group operates more than 6,400 domestic and 930 international flights each week⁶ using two complementary airlines: Qantas – a full service airline offering domestic and international services; and Jetstar – a low cost carrier offering domestic and international services, predominantly focussed on servicing price sensitive consumers. Qantas also operates airline related businesses including airport support services, catering, freight operations, loyalty programs and engineering.

The international destinations to which Qantas currently operates are set out in Table 1 and in the route map included as Annexure B to this submission.

Table 1: Qantas International Destinations (Ex Australia), July 2014

Region	Destinations
Pacific	Auckland, Christchurch, Wellington, Queenstown, Noumea, Port Moresby
Asia	Bangkok, Hong Kong, Jakarta, Manila, Shanghai, Singapore, Tokyo
Europe	London
Middle East	Dubai
Americas	Dallas/Fort Worth, New York, Los Angeles, Honolulu, Santiago
Africa	Johannesburg

As at 1 October 2014, the Qantas Group operated a total passenger fleet of 289 aircraft, comprising Boeing 787s, 747s, 767s, 737s and 717s, Airbus A380s, A330s and A320s, Bombardier Dash 8s and Bombardier Q400s.⁷

The Qantas Group is currently a party to the following alliances:

- a) an alliance with Emirates, which was authorised by the Commission on 27 March 2013;⁸
- b) an alliance with American Airlines pursuant to a Joint Business Agreement which was authorised by the Commission on 29 September 2011; and
- c) the **oneworld** marketing alliance.

Jetstar is a vital part of the Qantas Group's domestic and international operations. It operates low-cost, value based services in domestic Australia and to the following international destinations from a number of cities in Australia:

⁶ Qantas, *The Australian Way*, July 2014.

⁷ Ibid.

⁸ ACCC Determination in relation to Application for Authorisation lodged by Qantas Airways Limited and Emirates in respect of a Master Coordination Agreement to coordinate air passenger and cargo transport operations and other related services (A91332-A91333), 27 March 2013.

Table 2: Jetstar International Destinations (Ex Australia), July 2014

Region	Destinations
Pacific	Auckland, Christchurch, Queenstown, Nadi
South East Asia	Bangkok, Phuket, Bali (Denpasar), Jakarta, Manila, Singapore
North East Asia	Osaka, Tokyo
Americas	Honolulu

Since its establishment in 2004, the Jetstar Group has evolved into a mature and successful low cost carrier with an expanded brand presence as follows:

- a) domestic Australia and New Zealand services (operated by Jetstar Airways);
- b) international services from Australia to destinations in Asia, the Pacific and New Zealand (operated by Jetstar Airways); and
- c) services within and between various countries in Asia under the Jetstar business model, operated by the following joint ventures:
 - i. Jetstar Asia Airways Private Limited (**Jetstar Asia**) of which the Qantas Group has a 49% shareholding through its shareholding of Jetstar Asia's parent company, Newstar Investment Holdings Pte Ltd (a Singapore company) (Newstar), which is incorporated in Singapore and operates flights from Singapore to various destinations in Asia;⁹
 - ii. Jetstar Pacific Airlines Joint Stock Aviation Company (**Jetstar Pacific**) of which the Qantas Group has a 30% shareholding. Jetstar Pacific is incorporated in Vietnam and operates flights within Vietnam and to Singapore. It may, subject to regulatory approvals, operate international services from Vietnam to other destinations in Asia in the future;
 - iii. Jetstar Japan Co Ltd (**Jetstar Japan**) in which the Qantas Group has a 33% shareholding. Jetstar Japan is incorporated in Japan and began operating flights within Japan from 3 July 2012; and
 - iv. Jetstar Hong Kong Limited (**Jetstar Hong Kong**) in which the Qantas Group and China Eastern each have a 33⅓% shareholding.¹⁰ Jetstar Hong Kong proposes to operate flights from Hong Kong to China and various destinations in Asia, subject to regulatory approvals.

The Commission authorised coordination between the Qantas Group and the various Jetstar branded joint ventures in December 2012.

The Jetstar Group operates over 3,500 weekly flights to more than 60 destinations in 16 countries or territories with a combined operating fleet of around 115 aircraft.¹¹ A route map of the services currently provided by the Jetstar Group is set out in Annexure C.

More information about the Qantas Group is available at www.qantas.com.

⁹ References to Jetstar Asia in this submission include Valuair, a Singapore-based LCC that is wholly owned by Newstar and operates flights between Singapore and destinations in Indonesia.

¹⁰ The Proposed Conduct does not include co-ordination between Qantas or Jetstar and China Eastern in respect of Jetstar Hong Kong.

¹¹ Jetstar Network – Jetstar Group: <http://www.jetstar.com/mediacentre/facts-and-stats/jetstar-network> (Accessed 31 July 2014).

2.2 China Eastern

China Eastern is a full-service carrier and one of China's 'Big 3' airlines. Its main hubs are Shanghai's Pudong International and Hongqiao International airports, with secondary hubs at Kunming Changshui International Airport and Xi'an Xianyang International Airport.

China Eastern was established in 1988 following the Chinese Government's decision to create separate commercial airlines out of the Civil Aviation Administration of China (**CAAC**). China Eastern Air Holding Company (**CEAHC**), founded in 1996, is a state-owned enterprise incorporated in China and the parent company of China Eastern, with a shareholding of 64.36%.¹² China Eastern was listed on the Hong Kong, New York and Shanghai stock exchanges in 1997, becoming the first listed company in Chinese civil aviation industry. China Eastern's wholly owned subsidiary China Cargo Airlines provides freight services.

China Eastern is one of the largest carriers in the world by passengers flown. In 2013, it carried almost 80 million passengers.¹³ The company operates a large modern fleet with an average age of less than 7 years.¹⁴ As at 31 December 2013, China Eastern and its subsidiaries operated a fleet of 478 aircraft, which included 451 passenger aircraft (i.e. 5 Airbus A340s, 36 Airbus A330s, 7 Airbus A300s, 7 Boeing 767s, 33 Airbus A321s, 145 Airbus A320s, 23 Airbus A319s, 169 Boeing 737s, 8 Boeing 757s, 8 Bombardier CRJ200s and 10 Embraer 145LRs), 14 freight and 13 business aircraft.¹⁵

China Eastern has an established network throughout China and extending to Japan, Korea, South East Asia, Europe, North America and Oceania. In 2011, China Eastern became a member of the SkyTeam Alliance.

Route maps of China Eastern's current domestic and international services from its main hub Shanghai are set out in Annexure D.

More information about China Eastern is available on <http://en.ceair.com/> and <http://www.irasia.com/listco/hk/chinaeast/annual/>

3 THE PROPOSED CONDUCT

3.1 Current Codeshare Agreement

In respect of current services between Australia and China:

- a) Qantas operates a daily service between Sydney and Shanghai; and
- b) China Eastern operates a daily service between each of Sydney and Melbourne and Shanghai (with increased frequencies in peak periods), as well as a seasonal service to Cairns and a three times weekly service from Sydney to Beijing (via Nanjing).

In July 2008, the Applicants entered into the Current Codeshare Agreement, under which each carrier codeshares on various services operated by the other. The Current Codeshare Agreement includes provision for access to capacity:

- a) on a freesale basis:

¹² China Eastern Airlines Corporation Limited Annual Report 2013, p 49. Available: <http://www.irasia.com/listco/hk/chinaeast/annual/>. (Accessed 4 August 2014).

¹³ China Eastern Airlines Corporation Limited Annual Report 2013, p 4.

¹⁴ Ibid, p 14.

¹⁵ Ibid, p 13.

- i. by Qantas in respect of China Eastern's services between Sydney and Beijing (via Nanjing), between Singapore and Shanghai and between Shanghai and various destinations within China; and
 - ii. by China Eastern in respect of Qantas' services between Singapore and Sydney/Melbourne/Brisbane and various trans-Tasman and domestic services within Australia;
- b) on a hard block basis:
 - i. by Qantas in respect of China Eastern's Melbourne-Shanghai service; and
 - ii. by China Eastern in respect of Qantas' Sydney-Shanghai service.

The Current Codeshare Agreement does not include Qantas codesharing on China Eastern's Sydney-Shanghai service.

The Proposed Conduct seeks to move beyond the current limited codeshare relationship towards a new level of joint cooperation between the Applicants. There is no coordination under the Current Codeshare Agreement in relation to pricing, capacity, sales or marketing. Practical coordination of customer service is limited. Although Qantas and China Eastern have an existing arrangement under which members of Qantas' frequent flyer program can earn and redeem frequent flyer points on China Eastern's services (and vice versa), this proposition is currently limited and would only be enhanced as a result of the Proposed Conduct (as explained further below). Similarly, although Qantas and China Cargo Airlines have Special Prorate Agreements in place in respect of carriage of freight on each other's services, these arrangements do not involve any schedule or price coordination.

3.2 Joint Coordination Agreement

The Applicants entered into the Joint Coordination Agreement on 17 November 2014 (see Confidential Annexure A), for an initial term of 5 years.

Pursuant to the Joint Coordination Agreement,¹⁶ the Applicants desire to maximise consumer benefits and operate cost effective and efficient networks by coordinating their activities and operations, including in relation to:

- a) improving schedules, frequencies and connection times;
- b) enabling the expansion of destinations served by the Applicants' operations;
- c) expanding connecting services at primary gateways leading to more one-stop online points of service;
- d) developing new fare products and promotions;
- e) improving coordination of use of airport facilities by expanding reciprocal airport lounge access, improving facilities within lounges and streamlining check-in facilities for passengers;
- f) co-locating the Applicants' operations in Terminal 1 at Shanghai Pudong airport;
- g) increasing opportunities for frequent flyers who are members of one Applicant's frequent flyer program to earn and/or redeem frequent flyer points and take advantage of other membership benefits when travelling on the other Applicant;
- h) increasing the international competitiveness of both Applicants;

¹⁶ See clauses 3.2 and 3.3 of the Joint Coordination Agreement in Confidential Annexure A.

- i) easing the planning of itineraries through the provision of better information to agents; and
- j) improving reciprocal inventory access to facilitate more bookings on both Applicants' services, including group bookings.

Further, the Applicants may coordinate activities in respect of freight operations, sales and marketing (including joint promotions), holiday products and packages, distribution, customer rebates, incentives and discounts, agency arrangements, ground handling and airport services.

The exact scope of the Proposed Conduct will evolve and may be altered from time to time. The Applicants may add or remove routes and flights which are the subject of particular types of coordination.

The model of coordination will optimise the operating performance of both Applicants and will in turn optimise their financial performance. The Applicants have agreed to allow sales of each other's services on a freesale basis and will pay each other an upfront, monthly commission regardless of which carriers' code or ticket the passenger is travelling on. By selling in this way, each carrier has the ability to sell each other's capacity using the full range of available inventory. As discussed below, this will allow each carrier to offer a broader range of price points than is currently possible.

3.3 Rationale for the Proposed Conduct

The Australia-China passenger air services market is experiencing significant growth. This is evidenced by various measures. For example:

- there were 709,000 visitors from China during 2013, an increase of 14.5 per cent relative to 2012. Tourism Australia has projected that approximately 860,000 Chinese will visit Australia in 2020;¹⁷
- the overall Australia-China passenger air services market has experienced an average growth rate of 11% during the four years to April 2014.¹⁸ In the 12 months to June 2014, the Australia-China market grew by 7% in terms of capacity and 8% in terms of passenger numbers compared to the previous year;¹⁹ and
- growth in inbound tourism to Australia is forecast to be driven by significant growth from China, with 24% of international arrivals and 40% growth in expenditure from international tourists being sourced from China between 2012-2013 and 2022-2023.²⁰

Air services between Australia and China remain critical in the context of this growth and ongoing strong economic ties between the countries. As discussed further below, significant population growth and rising income levels in Asia (and specifically in China) will continue to dramatically transform the key sources of demand in the international aviation industry in the future.

However, neither carrier can effectively and efficiently serve the growing Australia-China market alone. Qantas needs a Chinese partner to most effectively provide a seamless customer proposition throughout China. As the data in Table 2 in Annexure F shows, despite the Australia-China market growing, Qantas' share has been declining. In the four years to April 2014, the Qantas Group's share (including Jetstar and Jetstar Asia) of total passengers on the Australia-China market has declined

¹⁷ *Tourism Australia Strategic Plan* (Accessed 29 July 2014). Available: http://www.tourism.australia.com/documents/Markets/China2020_Strategic_Plan.pdf

¹⁸ See Table 1 in Annexure E.

¹⁹ MIDT MAT Data, 30 June 2014.

²⁰ Tourism Research Australia Forecasts, Autumn 2014, p 28. Available: http://www.tra.gov.au/documents/forecasts/Tourism_Forecasts_Autumn_2014_FINAL_18062014.pdf (Accessed 6 October 2014).

from 21% to 15%. By contrast, over the same period, China Southern's share has increased from 11% to 22%. Similarly, as Table 3 in Annexure F shows, the Qantas Group's share (including Jetstar and Jetstar Asia) of total passengers travelling for a business purpose on the Australia-China market has declined from 27% to 21% in the four years to April 2014, whereas China Southern's share has increased from 6% to 18%.

The Proposed Conduct facilitates Qantas' growth in the Australia-China market in a way that would not otherwise be possible. Currently, Qantas is not earning a return on capital on its own operations, primarily due to its high cost base. By being able to expand its product offering by selling on China Eastern's services and coordinating complementary customer propositions, Qantas can improve its profitability without the need for significant additional capital outlay. Qantas will be able to utilise China Eastern's expansive sales and distribution network within China to help facilitate increased passenger flow onto its international and domestic services. This is an imperative given that the number of outbound passengers from China to Australia has grown in total by 22% in the year to 30 June 2014²¹. The Proposed Conduct will enable Qantas to offer a product proposition that is better aligned with the predominantly leisure-oriented and student passenger base out of China. 51% of total passengers travelling from China to Australia are travelling for holiday/leisure purposes, which has grown from 37% five years ago.²²

Given these market characteristics, without the Proposed Conduct, Qantas is likely to become increasingly marginalised in respect of the Australia-China market. Alone, Qantas will not be able to keep pace with the capacity growth being driven by carriers such as China Southern.

China Eastern needs an Australian partner to provide improved sales and distribution capability. The Proposed Conduct will enable China Eastern to build on Qantas' domestic business and frequent flyer proposition by accessing high-yielding Australian domestic corporate and government travellers. The Proposed Conduct will give China Eastern's worldwide sales force better access to sell to and from Australia, particularly by being able to offer more seamless travel to secondary and regional cities served by Qantas. Over the longer term, the Proposed Conduct will also result in operational efficiencies and cost savings which will allow China Eastern to enhance and expedite its long term capacity growth in Australia than would otherwise be the case. China Eastern will also benefit from the ability to access Qantas' extensive product knowledge and operational insights.

The Proposed Conduct allows both Applicants to realise their growth strategies for the Australia-China market. It brings together two complementary networks – while retaining brand, product and pricing differences. Consumers will still be able to choose between different product and price propositions, while simultaneously benefitting from aligned schedules and increased frequencies. As detailed further below, the Proposed Conduct will improve connectivity for Australian passengers transiting through Shanghai, while also materially facilitating capacity increases (through aircraft up-gauging and/or increased frequencies) and providing the basis for exploring opportunities to introduce new services on routes such as Brisbane and/or Perth to Shanghai.

Importantly, the Proposed Conduct will complement (rather than replace) Qantas' existing services to mainland China via Hong Kong. Qantas intends to retain its relationship with Cathay Pacific, under which Qantas passengers can join services operated by Cathay Pacific (or its subsidiary Dragonair) from Hong Kong into mainland China. Qantas does not consider the Hong Kong and Shanghai gateways to be mutually exclusive. In the context of the growing Australia-China market, Qantas needs to be able to service mainland China using both hubs. Customer choice will be enhanced in circumstances where Qantas can deliver an enhanced alternative transfer point in Shanghai, in addition to a differentiated product offering, with China Eastern.

²¹ MIDT MAT Data, 30 June 2014.

²² ABS, June 2014.

4 INTERNATIONAL AVIATION INDUSTRY

4.1 Economic Challenges

The Proposed Conduct will take place in the context of the unique economic and structural characteristics of the international aviation industry. The airline industry is highly capital intensive requiring large upfront investments in aircraft and associated equipment and facilities. High fixed operating costs, combined with other market features described below, make it difficult for an airline to recover capital costs on international routes.

Market features often produce high and sustained levels of excess capacity on particular routes, with capacity growth often preceding and outgrowing demand. In response to this challenge, carriers seek to fill that capacity by offering a superior product proposition and pricing to stimulate demand. However, carriers may continue to operate on a route despite low load factors and unprofitable results because they:

- a) need to offer their passengers (particularly corporate customers) a broad network proposition. Customer demand for a broad range of destinations and frequency of service means that carriers compete on the network spread they can offer. A full service airline may therefore need to offer a minimum level of services (for example, one flight per day) to make the route attractive to customers; and
- b) can only alter capacity on a route by several hundred seats at a time (that is, by adding or removing at least an extra aircraft). In this sense, airline capacity is 'lumpy' because increments can only be changed in large 'chunks.'

4.2 Barriers to Exit and Consolidation

While characteristics such as high fixed costs, excess capacity and returns below the cost of capital would ordinarily compel firms to exit or consolidate, there are reasons why neither of these outcomes eventuates in the international aviation industry.

Aviation markets are characterised by strategic barriers to exit. Although the number of airlines competing on the route may not be sustainable, no airline wants to be the one to exit (or scale down) operations because to do so will remove the potential for it to achieve returns should the other competitor be the one to exit first. Uncertainty regarding future prices and demand conditions may also lead an airline to continue operating while incurring losses in excess of fixed costs. This is because terminating services and resuming them at a later time is costly, especially if prices recover.²³

Further, for full service airlines such as Qantas, the decision to exit a route will depend both on the profitability of the route as well as the broader network benefits that accrue to the airline from offering services on that route (for example, increasing the attractiveness of its network to corporate customers). As mentioned above, these 'network effects' mean that in some circumstances it may be economically rational for a full service airline to maintain services on unprofitable routes.

There are also barriers to consolidation. Government regulations preclude airlines from merging or expanding into international markets to take advantage of economies of scale. Airlines are regulated through bilateral air services agreements (**ASAs**) between countries. ASAs set out the terms and conditions under which airlines from each country can provide air services to the other. Despite the movement to more liberal 'open skies' agreements, restrictions on servicing foreign markets still exist. A carrier will typically only be in a position to offer flights from its home country to specified gateways in another country. It will not be able to reach a broad range of cities in the destination country without an agreement with a carrier from that country.

²³ Oliver Wojahn, "Explaining Over-Capacity in the Airline Industry", January 2012, www.iata.org/whatwedo/Documents/economics/Wojahn_Jan2012.pdf (Accessed 22 August 2014)

ASAs also generally require that an international carrier must be ‘substantially owned and effectively controlled by nationals of the designated country’. Such ownership restrictions prevent airlines from achieving scale and network breadth via acquisition. Moreover, many governments still restrict foreign shareholdings in national airlines via legislation or foreign ownership rules. For example, no more than 49% of the total value of the issued share capital of an Australian international airline can be held by foreign interests.

These requirements have resulted in it being difficult for significant consolidation to occur in the international aviation industry. In addition, there are still a significant number of major international carriers (including the Chinese carriers) that are directly or indirectly owned by their respective governments. Government assistance to national carriers comes in many forms (including directly, through the periodic injection of free or subsidised capital, or indirectly through favourable policy settings, such as depreciation allowances for aircraft). As shareholders in or lenders to airlines, governments may subsidise the long term existence of those carriers.

4.3 Proliferation Of Alliances

The regulatory impediments to consolidate (or exit), coupled with the economic need to offer a broad network proposition in an increasingly competitive industry, have resulted in a growing number of international airlines forming strategic alliances.

Recent Commission determinations acknowledge that airline cooperation is a legitimate and essential way for airlines to remain viable in the face of rising costs and intense global competition:

- a) a joint venture between the Virgin Blue Group and Delta covering trans-Pacific routes in 2009;²⁴
- b) the (now terminated) Joint Services Agreement between Qantas and British Airways in 2010;²⁵
- c) an alliance between Virgin Blue and Air New Zealand covering New Zealand and Australia in 2011 (as reauthorised in 2013);²⁶
- d) an alliance between Virgin Blue and Etihad in 2011;²⁷
- e) a Joint Business Agreement between Qantas and American Airlines (Inc) in relation to trans-Pacific routes in 2011;²⁸
- f) an alliance between Virgin Australia and Singapore Airlines in relation to Australia-Singapore services in 2011;²⁹
- g) a commercial cooperation agreement between Etihad and airberlin PLC in 2012;³⁰
- h) an affiliation agreement between Emirates and flydubai in 2012;³¹

²⁴ ACCC Determination in relation to a Applications for Authorisation lodged by Virgin Blue Group and Delta Air Lines Inc in respect of a joint venture between the applicants (A91151, A91152, A91172 & A191173), 10 December 2009.

²⁵ ACCC Determination in relation to Applications for Authorisation lodged by Qantas and British Airways plc in respect of a Joint Services Agreement between the applicants (A91195 & A91196), 31 March 2010.

²⁶ ACCC Determination in relation to Applications for Authorisation lodged by Virgin Blue Airlines Pty Ltd and Others in respect of an alliance between the applicants (A91227 & A91228), 16 December 2010; ACCC Determination in relation to Applications for Authorisation lodged by Virgin Australia Airlines Pty Ltd, Air New Zealand and Others in respect of an airline alliance between the applicants (A91362 & A91363), 3 September 2013.

²⁷ ACCC Determination in relation to Applications for Authorisation lodged by Virgin Blue Airlines Pty Ltd and Others in respect of an alliance between the applicants (A91247 & A91248), 3 February 2011.

²⁸ ACCC Determination in relation to Applications for Authorisation lodged by Qantas and American Airlines in respect of a Joint Business Agreement between the applicants (91265 & A91266), 29 September 2011.

²⁹ ACCC Determination in relation to Applications for Authorisation lodged by Virgin Blue Airlines Pty Ltd and Singapore Airlines in respect of an alliance between the applicants (A91267 & A91268), 1 December 2011.

³⁰ ACCC Determination in relation to Applications for Authorisation lodged by Etihad Airways and airberlin in respect of a commercial alliance (A91307 and A91308), 25 July 2012.

- i) arrangements between the Star Alliance members to coordinate in relation to conventions and corporate dealing in 2012;³² and
- j) the Master Coordination Agreement between Qantas and Emirates in 2013.³³

The Proposed Conduct will take place in the context of these global industry trends. As described above, the Proposed Conduct represents part of Qantas' response to these trends. Faced with insufficient returns on capital, primarily due to its high cost base, Qantas is likely to become increasingly marginalised in respect of the Australia-China market unless it can cooperate with a Chinese partner airline.

5 APPROPRIATE FRAMEWORK FOR COMPETITION ASSESSMENT

5.1 Market Definition

Consistent with the Commission's approach in previous authorisation determinations in relation to international air passenger transportation services, it is not necessary to define the relevant market or markets with precision.

The Proposed Conduct will not result in a lessening of competition in any market, however defined, given the competitive dynamics and economic realities of the global aviation industry in which that conduct is proposed to take place. However, for the purposes of this submission, the appropriate markets in which to assess the impact of the Proposed Conduct are:

- a) the market for passenger air services between Australia and China; and
- b) the market for freight air services between Australia and Asia.

The characteristics of these markets, including market share trends, are set out further below.

5.2 Regional Dynamics

The competitive effects of the Proposed Conduct should be assessed in the context of the following regional economic dynamics:

- a) significant population growth in and around Asia, coupled with rising incomes. This will continue to dramatically transform the key sources of demand in the international aviation industry in the future. China's population is forecast to grow to 1.45 billion people by 2028.³⁴
- b) increasing average income and wealth in Asia. China's share of the total world GDP is expected to grow from 8.5% in 2013 to 16% by 2032.³⁵ In its Current Market Outlook, Boeing suggests this will see an expanding middle class expected to enjoy a comparable standard of living and consumption patterns.³⁶ The Asia Marketing Fund, announced by the Australian Government in the 2012-2013 Budget, provides A\$48.5 million over four years to promote

³¹ ACCC Determination in relation to Applications for Authorisation lodged by Emirates and flydubai in respect of an affiliation agreement (A91298 and A91299), 25 July 2012.

³² ACCC Determination in relation to Application for Authorisation lodged by Air New Zealand on behalf of the members of the Star Alliance in respect of Star Alliance's Corporate Plus, Conventions Plus and Meetings Plus Programs (A91300-A91306), 25 July 2012.

³³ ACCC Determination in relation to Application for Authorisation lodged by Qantas Airways Limited and Emirates in respect of a Master Coordination Agreement to coordinate air passenger and cargo transport operations and other related services (A91332-A91333), 27 March 2013.

³⁴ United Nations Press Release, 13 June 2013. Available: http://esa.un.org/unpd/wpp/Documentation/pdf/WPP2012_Press_Release.pdf (Accessed 22 August 2014).

³⁵ Boeing Current Market Outlook 2013-2032, p 20. Available: http://www.boeing.com/assets/pdf/commercial/cmo/pdf/Boeing_Current_Market_Outlook_2013.pdf (Accessed 22 August 2014)

³⁶ Ibid.

Australia as a tourism destination to the growing markets of Asia. Tourism Australia has also suggested that the Chinese inbound tourism market has the potential to contribute up to A\$9 billion annually to the Australian economy by 2020.³⁷

- c) increased demand for air travel in Asia. Boeing has predicted that during the next 20 years, half of the world's air traffic growth will be driven by travel to, from, or within the Asia Pacific region.³⁸ Total traffic for the region will grow 6.3% annually, due to national economic growth and the increasing accessibility of air transport services. Further, Boeing has suggested that traffic within the Asia Pacific region will grow faster than traffic to and from other regions.³⁹
- d) continued expansion of fleet size and order books of many Asian carriers. China continues to lead the Asia Pacific region in new aircraft deliveries. Over the next 20 years, Boeing expects the Chinese airlines will need nearly 6,000 new aircraft, accounting for more than 40% of forecast deliveries to the Asia Pacific region.⁴⁰ In terms of total passenger traffic, Chinese passenger growth has increased 17.8% over the first quarter of 2014 and 14.9% over the past 12 months.⁴¹ It has been predicted that by 2031, domestic Chinese traffic will be the largest flow in the world, accounting for 10.4% of total world traffic.⁴²
- e) increased numbers and sizes of airports and passenger volumes. For example, Beijing Capital Airport is expanding rapidly and is currently ranked as the world's second largest airport, with a total of over 73 million passengers.⁴³ Other Chinese airports are also expanding rapidly. The Civil Aviation Administration of China reportedly says that 80 new airports will be constructed in China by 2017 to facilitate air transport development.⁴⁴ The plan comes on the back of a blueprint issued by the Chinese State Council, which aims for China to have a total of 230 airports by the year 2017, with the majority in regional centres. More than 80% of China's population of over 1.3 billion will live within 100km of an airport once completed.⁴⁵

The relationship between Australia and China is expanding and diversifying. China is now Australia's largest two-way trading partner in goods and services (valued at more than A\$150 billion in 2013), our largest goods export destination (A\$95 billion in 2013) and our largest source of merchandise imports (A\$47 billion in 2013).⁴⁶ The Australia-China economic and trade relationship continues to steadily expand, with the Australian Government pursuing a number of initiatives to strengthen the relationship.⁴⁷

These regional social, political and economic factors drive competition between international airlines on a day to day basis and have a direct bearing on regional and local operations and business models. In this context, the Proposed Conduct will have no detrimental impact on real competitive dynamics within the Australia-China market.

³⁷ '2020 Highlights from Tourism Australia's activity in China in 2012-2013'. Available: http://www.tourism.australia.com/documents/Markets/China2020_MarketingHighlights_Oct13.pdf (Accessed 29 July 2014).

³⁸ Boeing Current Market Outlook 2013-2032, p 19. Available: http://www.boeing.com/assets/pdf/commercial/cmo/pdf/Boeing_Current_Market_Outlook_2013.pdf (Accessed 22 August 2014)

³⁹ Ibid

⁴⁰ Ibid.

⁴¹ ASX Release: Sydney Airport Limited (17 April 2014) 'Sydney Airport Traffic Performance March 2014'. Available: http://www.sydneyairport.com.au/investors/~/_media/files/investors/news%20and%20events/syd%20asx%20releases/2014/q2/170414%20asx%20release%20-%20sydney%20airport%20traffic%20performance%20march%202014.pdf

⁴² Airbus Total Market Forecast 2013-2032, Available: http://www.airbus.com/company/market/forecast/?eID=dam_frontend_push&docID=33752 (Accessed 22 August 2014).

⁴³ Flight Stats (PEK) Beijing Capital International Airport Overview. Available: <http://www.flightstats.com/go/Airport/airportDetails.do?airportCode=PEK>. (Accessed 29 July 2014).

⁴⁴ '80 new China airports' in *Travel Daily* 26 July 2012.

⁴⁵ Ibid.

⁴⁶ Department of Foreign Affairs and Trade Country Brief (Accessed 29 July 2014). Available: http://dfat.gov.au/geo/china/china_brief.html

⁴⁷ Department of Foreign Affairs and Trade Country Brief (Accessed 29 July 2014). Available: http://dfat.gov.au/geo/china/china_brief.html

5.3 Guiding Principles For Assessment

Given this global and regional context, the high level legal and economic principles that are relevant to assessing the Proposed Conduct include:

- a) understanding that the Proposed Conduct will produce limited detriment in circumstances where the Applicants have only one operating overlap;
- b) taking a forward looking approach that recognises that competitive constraints are not static and that strategic behaviour by market participants can affect competition;⁴⁸
- c) recognising that low barriers to entry and expansion are among the key indicators that an arrangement is unlikely to substantially lessen competition, particularly where it occurs in an industry that is rapidly evolving;⁴⁹
- d) recognising that arrangements equivalent to the Proposed Conduct are important to the efficient functioning of the economy because they allow firms to diversify risk, redress underperformance and achieve efficiencies such as economies of scale, scope or density;⁵⁰ and
- e) recognising that the Proposed Conduct will take place in a global, dynamic and innovative industry in which there is a high and increasing level of actual and potential import competition. This is demonstrated by the speed with which offshore carriers are expanding capacity and improving product quality on routes to and from Australia.

6 COMPETITION ANALYSIS

6.1 The Expanding Australia-China Passenger Air Services Market

As set out above, for the purposes of this submission, the appropriate market in which to assess the effect of the Proposed Conduct in respect of passenger services is the market for passenger air services between Australia and China.

Air services between Australia and China are a critical element in the context of the ongoing development of strong economic ties between the countries. As described earlier, the market for passenger air travel between Australia and China is large and growing. In August 2014, both Sydney and Melbourne airports reported a 20 per cent increase in Chinese visitors.⁵¹

Data measuring the number of Chinese visitors to Australia and the number of Australian residents departing temporarily to China clearly reflect the growth of this market, as set out in Figures 1 and 2 below.

⁴⁸ ACCC Merger Guidelines, November 2008 (ACCC Merger Guidelines), p 12.

⁴⁹ Ibid p 49.

⁵⁰ Ibid, p 3.

⁵¹ 'China Southern upbeat on tourists' in *Sydney Morning Herald* 22 September 2014.

Figure 1: China Visitor Arrival Movements – Trend



Source: ABS

Figure 2: China Visitor Arrival Movements – Year on Year

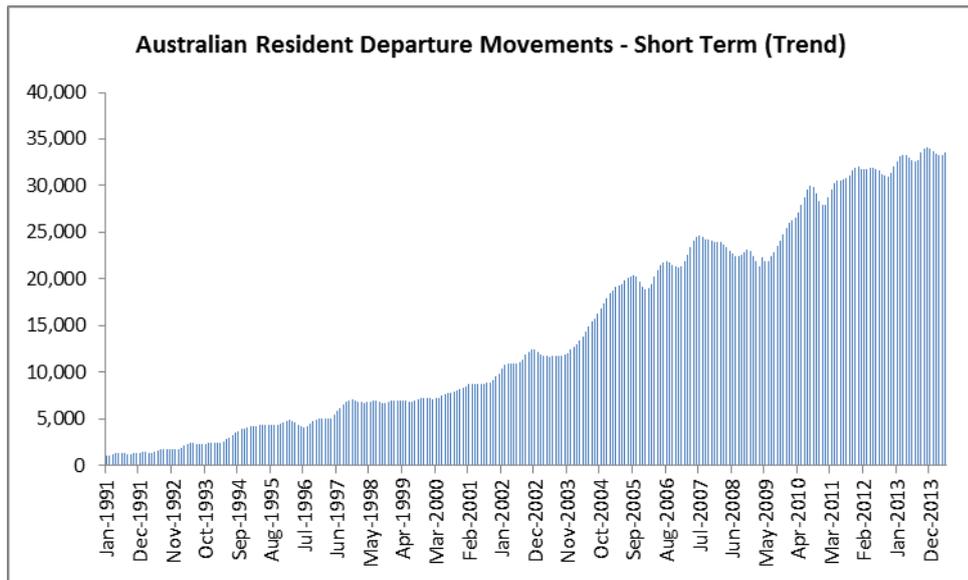


Source: ABS

The growth in Chinese visitor arrivals in the 12 months to May 2014 represented a 12% increase on the previous year.

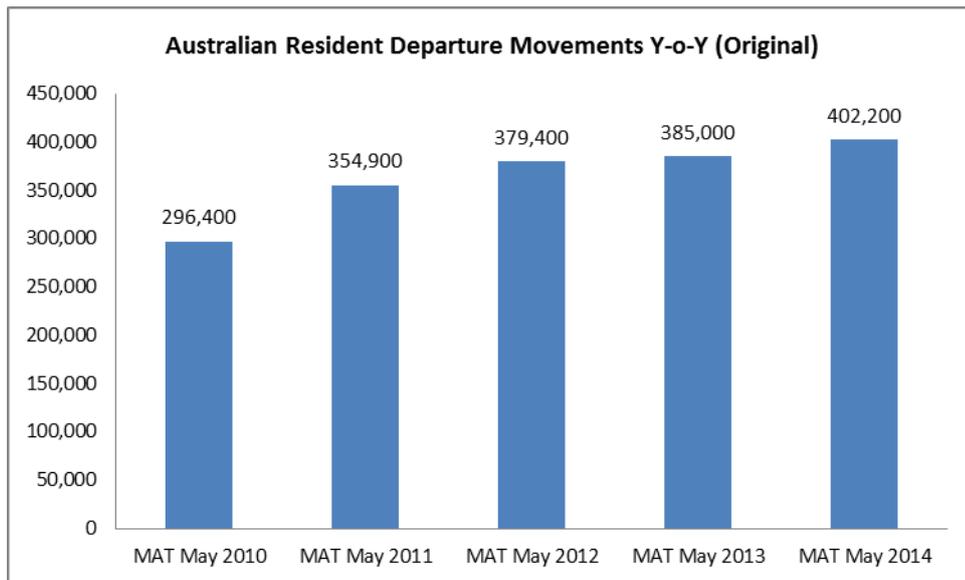
Similar trends are evident in respect to the numbers of Australian residents departing for short term stays in China, as set out in Figures 3 and 4 below.

Figure 3: Australian Resident Short Term Departures to China – Trend



Source: ABS

Figure 4: Australian Resident Short Term Departures to China – Year on Year



Source: ABS

The growth in numbers of Australian residents departing for short term stays to China in the 12 months to May 2014 reflect a 4% increase compared to the previous year.

The top gateway destinations within the Australia-China market are:

- a) Shanghai;
- b) Beijing;
- c) Guangzhou;
- d) Nanjing;
- e) Fuzhou; and

- f) Chengdu.

Services to these destinations have been growing. For the 12 months up to 30 June 2014, routes between Australia and each of these destinations recorded the following growth patterns:⁵²

- a) Shanghai experienced 7% growth in capacity and 7% growth in passengers;
- b) Beijing experienced 2% growth in capacity and 2% growth in passengers;
- c) Guangzhou experienced 0% growth in capacity and 1% growth in passengers;
- d) Nanjing experienced 31% growth in capacity and 31% growth in passengers;
- e) Fuzhou experienced 6% growth in capacity and 7% growth in passengers; and
- f) Chengdu experienced 28% growth in capacity and 29% growth in passengers.

The route between Sydney and Shanghai – the only one in relation to which there is any operational overlap between the Applicants – forms only part of the overall Australia-China market.

As detailed below, third country carriers also play an important role in the Australia-China market, carrying around a quarter of total passenger traffic over major hubs such as Singapore and Hong Kong.

6.2 Limited Competitive Detriment

The analysis below highlights that there will be limited competitive detriment arising from the Proposed Conduct in respect of both passenger and freight services because:

- a) there is limited operational overlap, given that Shanghai-Sydney is the only route on which both Applicants operate;
- b) the Applicants will continue to be disciplined by a number of rivals who are already acting as effective constraints on highly competitive routes;
- c) the Applicants will remain constrained by potential expansion and low barriers to new entry; and
- d) the Proposed Conduct is pro-competitive because (among other public benefits) it will:
 - i. enable the Applicants to more effectively compete against rivals by preserving, but also enhancing, customer choice by improving the transit journey through Shanghai to make it a genuine competitive alternative to other hubs;
 - ii. facilitate capacity increases through aircraft up-gauging and increased frequencies, while also providing the basis for exploring opportunities to introduce new direct services between Australia and China (namely between Brisbane and/or Perth and Shanghai);
 - iii. elicit a pro-competitive response from rival carriers, in particular China Southern and Sichuan Airlines, as well as from hubs competing with Shanghai to attract Australian transit passengers;
 - iv. expedite China Eastern's growth in Australia; and
 - v. prevent Qantas from becoming an increasingly marginal operator on the Australia-China market.

⁵² MIDT MAT, June 2014.

6.3 Limited Overlap

Overlap between the Applicants is limited. In terms of actual flying operations between Australia and China, Qantas and China Eastern only overlap on one route – Sydney-Shanghai.

Table 4: Applicants' Current Australia-China Operations (Northern Winter 2014 Schedules)

Operating Carrier	Route	Schedule
Qantas Airways	Sydney-Shanghai	Daily (depart 1050, arrive 1830)
	Shanghai-Sydney	Daily (depart 2005, arrive 0940)
China Eastern	Sydney-Shanghai	Daily (depart 1200, arrive 1920) *Daily (depart 2130, arrive 0500)
	Shanghai-Sydney	Daily (depart 2020, arrive 1000) *Daily (depart 2355, arrive 1335)
	Melbourne-Shanghai	Daily (depart 1200, arrive 1920) *Daily (depart 2230, arrive 0605)
	Shanghai-Melbourne	Daily (depart 2015, arrive 1000) *Daily (depart 2355, arrive 1340)
	Sydney-Nanjing-Beijing	3pw (depart 1130, arrive 2325)
	Beijing-Nanjing-Sydney	3pw (depart 1550, arrive 0930)

Note:

* Sydney-Shanghai: additional daily China Eastern operations for travel 27 October 2014-4 March 2015, reducing to 2 frequencies per week from 3 April 2015.

* Melbourne-Shanghai: additional daily China Eastern operations for travel 30 November 2014-9 March 2015.

Qantas also serves the Australia-China market through its own operated services to Hong Kong and through interlining on Cathay Pacific and Dragonair into mainland China. As mentioned above, the Proposed Conduct will not impact on these services because Hong Kong is still considered to be a viable alternative to Shanghai as a gateway into China. They are not mutually exclusive gateways and both form part of the broader Australia-China market.

For completeness, the Applicants could also be said to overlap to the extent that they each sell space on each other's services. As set out above, under the Current Codeshare Agreement the Applicants codeshare on various of the other's services. However, the Commission has acknowledged in previous determinations that a lack of operating overlap means that collaboration is unlikely to cause competition concerns. For example, in considering the Joint Business Agreement between Qantas and American Airlines, the Commission noted that the absence of any direct operating overlap meant that the collaboration was unlikely to have an anti-competitive effect.⁵³

Similarly, although the (now terminated) Joint Services Agreement between Qantas and British Airways (BA) allowed the Applicants to coordinate on *any* routes across their respective networks, the Commission only focussed its competition assessment on routes where the Applicants' actual operations otherwise *overlapped*.⁵⁴ The Commission noted that although the Joint Services Agreement was not restricted in the routes to which it could apply, 'anticompetitive detriment can only arise on routes where Qantas and BA would otherwise compete'⁵⁵ and 'it is essentially only on routes between Australia and UK/Europe that both Qantas and BA maintain an operating presence and there is a potential for a lessening of competition.'⁵⁶

⁵³ See for example para 4.72 and para 4.79 of the ACCC's Determination, n 33 above.

⁵⁴ JSA Determination, n 30 above, paras 2.15 and 4.13.

⁵⁵ *Ibid*, para 4.136.

⁵⁶ *Ibid*, para 4.172.

Given this approach, the focus in this submission is on the limited operational overlap between the Applicants in respect of the Australia-China market.

6.4 Effective Competitive Constraints – Passenger Services

As set out above, for the purposes of this submission the appropriate market for assessing competitive effects is the market for passenger air services between Australia and China.

The data in Table 1 in Annexure F (using MIDT MAT data measured to June 2014) indicates that in relation to the number of passengers on services between Australia and China:

- a) the Qantas Group (including Jetstar and Jetstar Asia) has a market share of 10.3%;
- b) China Eastern has a market share of 19.33%; and
- c) the Proposed Conduct will therefore result in the Applicants having a combined share of 29.63% of all passengers travelling between Australia and China.

Even combined, this is only slightly higher than China Southern's share of 27.2%. Cathay Pacific's share is also significant, being 17%.

An alternative measure of market share, using ABS data measured to April 2014 (see Table 2 in Annexure F), indicates that in relation to the number of passengers on services between Australia and China:

- a) the Qantas Group (including Jetstar and Jetstar Asia) has a market share of 15%;
- b) China Eastern has a market share of 14%; and
- c) the Proposed Conduct will therefore result in the Applicants having a combined share of 29% of all passengers travelling between Australia and China.

China Southern has a substantially similar share of 22%. Cathay Pacific's share is also significant, being 17%.

Given that the Commission has previously sought to isolate markets on a city-pair basis depending on whether the 'purpose of travel' identified is leisure or business, to assist the Commission data is also provided in relation to international air passenger services between:

- a) Australia and China in respect of business purpose travellers (see Table 3 in Annexure F);
- b) Australia and China in respect of leisure purpose travellers (see Table 4 in Annexure F); and
- c) each of Sydney and Shanghai (see Table 5 in Annexure F).

The Australia-China market is highly competitive. The Applicants will remain constrained by other rivals operating direct and (closely substitutable) indirect weekly services including⁵⁷:

- a) China Southern with 32 return frequencies to Guangzhou;
- b) Air China with 15 return frequencies to Beijing and Shanghai;
- c) Cathay Pacific with 78 return frequencies to Hong Kong, with Cathay/Dragonair having 433 return frequencies beyond to China;
- d) Sichuan Airlines with 5 return frequencies to Chengdu and Chongqing;

⁵⁷ Frequency information sourced from CSI Data NW14 and Amadeus Schedule Information.

- e) Singapore Airlines with 113 return frequencies to Singapore; with 56 return frequencies beyond to China; and
- f) Malaysia Airlines with 72 return frequencies to Kuala Lumpur; with 40 return frequencies beyond to China.

Further information about the key competitors on the Australia-China market is set out below.

China Southern

China Southern is the largest air transport service provider in China – it is the largest Chinese airline by capacity, fleet and passengers flown.⁵⁸ In 2013, China Southern transported more than 90 million passengers, ranking it first in Asia and third of global airlines measured by IATA.⁵⁹

The airline is majority owned by China Southern Air Holding Company (CSAHC), which has a 42.67% shareholding.⁶⁰ CSAHC is a state-owned asset⁶¹ managed directly by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) under the direction of the Chinese Government.⁶² China Southern's subsidiaries include:

- a) Xiamen Airlines, a full-service airline operating 218 domestic routes to all major cities and tourist destinations across China, as well as 26 international and regional routes;⁶³
- b) Chongqing Airlines, a full-service airline operating domestic passenger services from Chongqing Jiangbei International Airport;⁶⁴ and
- c) Sichuan Airlines, which also operates between Australia and China, as described further below.

China Southern's base and primary hub is Guangzhou Baiyun Airport, with additional hubs in Beijing, Chongqing and Urumqi. It operates to 190 destinations across Asia, the Middle East, the Americas and Europe. It has more than 500 passenger and cargo aircraft.⁶⁵ China Southern has an aggressive global fleet expansion plan. In October 2011, it took delivery of the first of five A380 aircraft, becoming the first Chinese carrier to operate this type of aircraft.⁶⁶ It now has five A380 aircraft in service, with one operating between Sydney and Guangzhou, and was the first carrier to operate both an A380 and a 787 Dreamliner.

China Southern is the key operator on the Australia-China market, with 27.2% share of total passenger traffic (based on MIDT data to June 2014; see Table 1 in Annexure F). The airline experienced passenger share growth of 3% relative to last year (based on MIDT data to June 2014; see Table 1 in Annexure F). To Guangzhou, it operates twice daily services from Sydney, up to two daily services from Melbourne, up to daily services from Brisbane and three services per week from Perth.

⁵⁸ China Southern website: http://www.csair.com/en/about/static/gongsijianjie.shtml?subsite=AU_EN (Accessed 8 August 2014).

⁵⁹ China Southern website: http://www.csair.com/en/about/static/gongsijianjie.shtml?subsite=AU_EN (Accessed 8 August 2014).

⁶⁰ 'China Southern First Quarterly Report 2014', p 3, China Southern. Available: (Accessed 8 August 2014).

http://www.csair.com/en/about/report/2014/20140428_1.pdf

⁶¹ 'Central SOEs', SASAC.gov.cn. Available: <http://www.sasac.gov.cn/n2963340/n2971121/n4956567/4956583.html>. (Accessed 22 August 2014).

⁶² 'Main Functions and Responsibilities of SASAC', SASAC.gov.cn. Available:

<http://www.sasac.gov.cn/n2963340/n2963393/2965120.html>. (Accessed 22 August 2014).

⁶³ 'About Us', Xiamen Airlines. Available: <http://www.xiamenair.com/cn/en/aboutus/>. (Accessed 23 January 2014).

⁶⁴ 'Profile on Chongqing Airlines', CAPA – Centre for Aviation. Available: <http://centreforaviation.com/profiles/airlines/chongqing-airlines-og>. (Accessed 24 January 2014).

⁶⁵ China Southern website: http://www.csair.com/en/about/static/gongsijianjie.shtml?subsite=AU_EN (Accessed 8 August 2014).

⁶⁶ 'Airbus delivers China Southern Airlines' First A380', Airbus Press Release, 14 October 2011. Available:

<http://www.airbus.com/presscentre/pressreleases/press-release-detail/detail/airbus-delivers-china-southern-airlines-first-a380/>

China Southern's presence in the Australia-China market poses a real and effective competitive constraint on the Applicants and will continue to do so going forward. One of China Southern's key priorities is strategic transformation and internationalisation, with enhanced operational capability for international long haul travel.⁶⁷ China Southern's Chairman has stated that the carrier is expanding its international network by leveraging its extensive domestic network and its transit hub in Guangzhou so that international routes grow to become 30% of its total network.⁶⁸ In 2013, China Southern reiterated its commitment to developing Guangzhou as a transit hub with new products and services to optimise the passenger experience.⁶⁹

Importantly, in this context, China Southern has stated that Australia remains its 'most important overseas market'.⁷⁰ In August 2012, China Southern officially opened its new regional headquarters for Australia and New Zealand in Sydney, the airline's first overseas office.⁷¹ China Southern has signed a \$9 million agreement with Tourism Australia, state tourism bodies and each of Sydney, Melbourne, Brisbane, Perth and Guangzhou Baiyun airports to develop and market its services.⁷² In August 2014, China Southern renewed the agreement with Tourism Western Australia – to coincide with the launch of direct services between Perth and Guangzhou, both parties committed to spending \$2.4 million each over the next three years to promote links between China and Western Australia.⁷³ In 2013, the airline participated in the Sydney Festival, sponsored opera performances and sponsored the Melbourne Festival as part of its marketing effort within Australia.⁷⁴ Strengthening brand awareness is one of China Southern's priorities for 2014.⁷⁵

Sichuan Airlines

Sichuan Airlines, in which China Southern has a 39% shareholding, was established in 2002 and is an effective competitor on routes between Australia and China. Based in Chengdu in China, Sichuan Airlines has 90 aircraft serving more than 80 cities in China. Sichuan Airlines now operates services three times a week from Melbourne to Chengdu and two times a week from Sydney to Chongqing. The Melbourne services commenced in February 2013 and the Sydney services commenced in December 2013. In the year to 30 June 2014, Sichuan Airlines experienced 194% growth in passenger numbers relative to the previous year by carrying over 43,000 passengers between Australia and China (based on MIDT data; see Table 1 in Annexure F).

Air China

Air China was established in 1988 following the Chinese government's decision to create separate commercial airlines out of the Civil Aviation Administration of China (**CAAC**). Air China is listed on the Hong Kong and London stock exchanges. It is the national flag carrier for China. Air China's base and most important hub is Beijing Capital International Airport. Its secondary hub is Shanghai Pudong International Airport.⁷⁶ The carrier has 461 aircraft servicing 29 countries.⁷⁷

Air China operates services to Beijing from Sydney up to seven times a week, from Melbourne five times a week and to Sydney from Shanghai three times a week and Melbourne five times per week.

⁶⁷ China Southern Annual Report 2013, p13 Available: http://www.csair.com/en/about/report/2014/20140422_1.pdf (Accessed 22 August 2014).

⁶⁸ 'China Southern Airlines: 'Now is good time for our business to go abroad'', CAPA, 25 July 2012.

⁶⁹ China Southern Annual Report 2013, p 16. Available: http://www.csair.com/en/about/report/2014/20140422_1.pdf (Accessed 8 August 2014).

⁷⁰ Ibid.

⁷¹ 'China Southern launches new Australian HQ,' in *Travel Daily* 9 August 2012.

⁷² '\$13m CZ Aussie marketing' in *Travel Daily* 15 August 2012.

⁷³ 'Tourism Western Australia, China Southern strengthen collaboration' Available: http://www.ttgasia.com/article.php?article_id=23583 (Accessed 8 August 2014).

⁷⁴ China Southern Annual Report 2013, p 9, 11. Available: http://www.csair.com/en/about/report/2014/20140422_1.pdf (Accessed 8 August 2014).

⁷⁵ China Southern Annual Report 2013, p 21. Available: http://www.csair.com/en/about/report/2014/20140422_1.pdf (Accessed 8 August 2014).

⁷⁶ 'Profile on Air China', CAPA – Centre for Aviation. Available: <http://centreforaviation.com/profiles/airlines/air-china-ca>. (Accessed 20 January 2014).

⁷⁷ Air China website. Available: <http://www.airchina.com.au/en/aboutus/companyprofile.html> (Accessed 11 August 2014).

Cathay Pacific

Cathay Pacific operates services to Hong Kong, with connections to mainland China, from Sydney, Melbourne, Brisbane, Adelaide, Cairns and Perth. Cathay Pacific operates to 47 destinations across Asia, Europe, Africa, the Middle East and North America. It has a fleet size of 142 aircraft, with 89 on firm order.⁷⁸ Cathay Pacific is ranked 14th in the world in terms of revenue passenger kilometres⁷⁹ and in July 2014 was named 'World's Best Airline'.⁸⁰

Despite offering an indirect service via Hong Kong, Cathay Pacific is the other main operator on the Australia-China market, behind China Southern. Passenger services are operated from Hong Kong through Cathay Pacific's wholly owned subsidiary, Dragonair. Its Hong Kong hub provides efficient connections for Australia-China traffic. Unlike Shanghai, passengers transiting through Hong Kong have the advantage that there is no need to clear customs or recheck baggage –their connection between flights arriving from Australia and those departing to mainland China is seamless.

Singapore Airlines

Singapore Airlines is the national carrier of Singapore. Along with its subsidiaries, Singapore Airlines is engaged in passenger and cargo transportation, airport terminal services, engineering services, training of pilots and other related activities. It uses a fleet of wide-body Boeing and Airbus aircraft⁸¹ and operates an extensive network to over 60 destinations across Asia, North America, Australasia, Europe, Africa and the Middle East.⁸² As at 30 June 2014, Singapore Airlines operated a fleet of 103 passenger aircraft (including 27 Airbus A330s, 19 Airbus A380s and 57 Boeing 777s) with an average age of 6 years and 11 months.⁸³ As at 31 March 2014, Singapore Airlines had 118 aircraft on firm order.⁸⁴

From Australia, Singapore Airlines operates four daily services to Singapore from Melbourne, Sydney, and Perth with onward connections to destinations in China (to Guangzhou, Beijing and Shanghai). In June 2014, Singapore Airlines announced the deployment of an A380 aircraft on the Singapore-Beijing route.⁸⁵

In November 2013, Singapore Airlines signed agreements with six tourism organisations in Australia in line with its ongoing efforts to promote tourism to Australia with the total investment for the financial year amounting to more than \$5 million.⁸⁶ This was on top of the existing four-year agreement with Tourism Queensland to jointly promote Queensland tourism through the airline's services to Brisbane. Under the agreement, Singapore Airlines and Tourism Queensland fund a range of campaigns and promotional activities aimed at driving tourism to Queensland.⁸⁷

Singapore Airlines' subsidiary Tiger Airways operates services from Australia (Perth) to Singapore and on to regional destinations in South East Asia, including China.⁸⁸ Singapore Airlines also wholly

⁷⁸ Cathay Pacific website. Available http://downloads.cathaypacific.com/cx/press/cxw/CX_Fact%20Sheet_en.pdf (Accessed 11 August 2014).

⁷⁹ Cathay Pacific website. Available http://downloads.cathaypacific.com/cx/press/cxw/CX_Fact%20Sheet_en.pdf (Accessed 11 August 2014).

⁸⁰ 'Cathay Pacific named World's Best Airline for fourth time in annual Skytrax Awards' Media Release 15 July 2014. Available: http://www.cathaypacific.com/cx/en_HK/about-us/press-room/press-release/2014/cathay-pacific-named-worlds-best-airline-for-fourth-time-in-annual-skytrax-awards.html (Accessed 11 August 2014).

⁸¹ 'Singapore Airlines Annual Report 2012/13', p 196. Available: <http://www.singaporeair.com/pdf/Investor-Relations/Annual-Report/annualreport1213.pdf>. (Accessed 8 January 2014).

⁸² 'Where we fly', Singapore Airlines. Available: http://www.singaporeair.com/en_UK/plan-and-book/where-we-fly/. (Accessed 15 August 2014).

⁸³ Singapore Airlines press release 31 July 2014. Available: <http://www.singaporeair.com/pdf/Investor-Relations/Financial-Results/News-Release/nr-q1fy1415.pdf> (Accessed 15 August 2014).

⁸⁴ Singapore Airlines Annual Report 2013/14. Available: <http://www.singaporeair.com/pdf/Investor-Relations/Annual-Report/annualreport1314.pdf> (Accessed 15 August 2014).

⁸⁵ Singapore Airlines Press Release 10 June 2014. Available: http://www.singaporeair.com/jsp/cms/en_UK/press_release_news/ne140610.jsp (Accessed 15 August 2014).

⁸⁶ 'Singapore Airlines Annual Report 2012/13', p 15.

⁸⁷ 'Singapore Airlines reaffirms partnership with Tourism Queensland', Singapore Airlines. Available: http://www.singaporeair.com/jsp/cms/en_UK/press_release_news/ne110722.jsp. (Accessed 10 January 2014).

⁸⁸ 'Where we fly', Tigerair. Available: http://www.tigerair.com/au/en/destination_map.php. (Accessed 15 August 2014).

owns Scoot, a low cost carrier which operates from Australia to Singapore (again with onward services to China). Singapore Airlines has a 22.17% shareholding in Virgin Australia,⁸⁹ reinforcing its commitment and interest in the Australian market.

Malaysia Airlines

Malaysian Airline System Berhad operates as Malaysia Airlines and is the government owned national flag carrier of Malaysia, with a home hub at Kuala Lumpur. Malaysia Airlines operates an extensive international network to 80 destinations in 30 countries across Asia Pacific, Europe and North America.

From Australia, Malaysia Airlines operates services to Kuala Lumpur, with connections to China, from Adelaide, Brisbane, Melbourne, Perth, Sydney and Darwin. Malaysia Airlines flies to a number of destinations in China – specifically, Beijing, Guangzhou, Kunming, Shanghai and Xiamen.

6.5 Effective Competitive Constraints – Freight Services

For the purposes of this submission, the appropriate market for assessing competitive effects in respect of freight is the market for air freight services between Australia and Asia. As the Commission has previously acknowledged,⁹⁰ freight markets are generally defined more widely than passenger markets given that indirect services are more likely to be regarded as close substitutes for direct services than would be the case for passenger services. In light of the above, providers of air freight services are generally price takers in the market. This will not change as a result of the coordination of freight operations by the Applicants.

As the Commission is aware, the majority of freight to and from Australia is carried on passenger flights and, as such, the level of competition is affected by many of the same factors as for passenger services. There are typically more volumes of freight into Australia than out of Australia.

In addition to freight carried in bellyspace in passenger operations, Qantas also operates the following dedicated freighter services:

- a) from Sydney to Shanghai (via Bangkok and onwards to the US) on a twice weekly basis;
- b) from Sydney to Shanghai (via Chongqing and onwards to the US) on a weekly basis;
- c) from Sydney to Shanghai (onwards to the US) on a weekly basis;
- d) from Sydney to Shanghai direct on a twice weekly basis;
- e) from Shanghai to Sydney direct on a weekly basis.

In January 2014, on the basis of financial performance, Qantas ceased operating a third aircraft to and from China upon expiry of aircraft wetlease arrangements.

China Eastern carries freight in the bellyspace of its passenger services, but does not operate any dedicated freighters to or from Australia.

The Applicants have estimated their combined share of the market for freight services from Australia to Asia (as at 30 June 2014) to be approximately 21.15%, comprising Qantas' share of 19.16% and China Eastern's share of 2.0%. Further freight data is set out in Confidential Annexure G.

The market for air freight services between Australia and Asia is highly competitive. Freight markets are characterised by substantial excess capacity, meaning that consignments are vigorously

⁸⁹ See 'Notice of change in substantial shareholding' lodged with ASX 28 March 2014. Available: <http://www.asx.com.au/asxpdf/20140328/pdf/42nnt99mzcfcc0.pdf> (Accessed 15 August 2014).

⁹⁰ Etihad/airberlin Determination, para 3.4; Air New Zealand/Virgin Australia Determination, para 5.463.

contested and prices are driven down. The Applicants will continue to remain constrained by other rivals operating direct (and closely substitutable) passenger services (with bellyspace for freight carriage). In addition to bellyspace on passenger services direct into China (offered by carriers such as China Southern and Air China), Singapore Airlines operates 6 weekly dedicated freighters out of Australia, Cathay Pacific operates 2 weekly dedicated freighters out of Australia and Malaysia Airlines operates 2 weekly dedicated freighters out of Australia.

There are also many specialised freight operators providing significant (one way, northbound) freight services from Australia to Asia including DHL, United Postal Services (**UPS**) Airlines and Federal Express. Most full service airlines and specialist freight operators have large freight networks and a high frequency of freight services.

6.6 Low Barriers To Entry And Expansion

The Australia-China air passenger services market is characterised by low barriers to entry and expansion, meaning that the Applicants will remain constrained by the prospect of new entrants and the expansion of existing carriers. The Applicants consider expansion by existing carriers, particularly China Southern and Sichuan Airlines, to be likely immediately in response to the Proposed Conduct.

The ASA between Australia and China includes an entitlement of 22,500 seats each way per week to and from Sydney, Melbourne (including Avalon), Brisbane and Perth for passenger services. Unrestricted capacity may be operated to and from all other points in Australia. An additional 2,500 weekly seats may be operated between China and Sydney, Melbourne (including Avalon), Brisbane and Perth, provided such services operate via or beyond to any other point in Australia. Based on the Northern Summer 2014 scheduling season, Chinese carriers are utilising up to 15,993 seats per week to/from Australia's four main gateways and Australian carriers are utilising up to 2,079 seats per week. Carriers have approval to exceed their weekly entitlement to meet increased visitor demand during peak periods.⁹¹

The Australian Government has referred to the fact that the number of Chinese visitors to Australia grew 18% from 2011-2012 to 2012-2013 to reach more than 685,000 people, resulting in \$4.4 billion of direct economic benefit.⁹² In light of this, the Australian Government has stated:

'We want to see those figures increase and we are actively supporting the industry to achieve that goal with this decision and other measures, such as addressing regulation, barriers to tourism infrastructure project approvals and encouraging foreign direct investment in the sector.'

'...We are also heavily promoting Australia as a tourism destination in China through our marketing efforts overseen by Tourism Australia, which includes a number of partnership agreements with Chinese aviation carriers...'⁹³

The ASA provides for growth opportunities for Australian and Chinese carriers (as well as third country carriers) in the short term and the Australian Government has a standing commitment to work towards an end objective of an open skies agreement with China over the longer term.⁹⁴ The Australian Government has stated:

'To increase global aviation industry liberalisation the Government has confirmed it will prioritise key bilateral air services agreements to ensure we will continue to have the capacity to meet future demand. We will also protect our national interest, and strongly support

⁹¹ 'Additional airline seats approved to support Chinese New Year period' Media Release of Deputy Prime Minister, Minister for Infrastructure and Regional Development The Hon Warren Truss and Minister for Trade and Investment The Hon Andrew Robb, 5 February 2014. Available: http://www.trademinister.gov.au/releases/Pages/2014/ar_mr_140205.aspx?ministerid=3 (Accessed 6 October 2014).

⁹² Ibid.

⁹³ Ibid.

⁹⁴ Address to CAPA Aviation Summit 2014, 8 August 2014 by Mr Mike Mrdak, Secretary, Department of Infrastructure and Regional Development, p 9. Available: http://www.infrastructure.gov.au/department/media/files/2014/20140808_CAPA.pdf (Accessed 6 October 2014).

*sustainable industries and facilitate the expansion of the Australian industry and Australian airlines into foreign markets...*⁹⁵

*'...The growth in the Chinese market has been a constant theme of industry discussions in recent years. The growth has been enormous: In 1992, one direct flight a week served a market of around 85,000 passengers per year. Today, 75 direct flights a week serve a market of more than 2.4 million passengers every year. And growth in the China market is predicted to continue, at around 10 per cent each year.'*⁹⁶

From a freight perspective, the barriers to entry and expansion in all relevant regions are also low. Freight capacity, particularly dedicated freight capacity, tends to quickly and closely follow demand. This means that freight services are often either introduced or cancelled on a week to week or day to day basis depending on load factors. Given that most dedicated freight services operate at non-peak time slots, obtaining landing rights is generally not an issue for new or returning operators. The ASA between Australia and China provides for unlimited dedicated freighter capacity for both Australian and Chinese carriers.

6.7 The Proposed Conduct Is Pro-Competitive

As set out above, the Proposed Conduct is pro-competitive because (among other public benefits) it will:

- a) enable the Applicants to more effectively compete against rivals by preserving, but also enhancing, customer choice by improving the transit journey through Shanghai to make it a genuine competitive alternative to other hubs;
- b) facilitate capacity increases through aircraft up-gauging and increased frequencies, while also providing the basis for exploring opportunities to introduce new direct services between Australia and China (namely between Brisbane and/or Perth and Shanghai);
- c) elicit a pro-competitive response from rival carriers, in particular China Southern and Sichuan Airlines, as well as from hubs competing with Shanghai to attract Australian transit passengers;
- d) expedite China Eastern's growth in Australia; and
- e) prevent Qantas from becoming an increasingly marginal operator on the Australia-China market.

The Proposed Conduct is a competitive response by the Applicants to expansion by other rivals, particularly China Southern, on routes between Australia and China. The Proposed Conduct will enhance the Applicants' ability to compete more effectively against these rivals. The Proposed Conduct is designed to facilitate growth and expanded product offerings. It will therefore not only preserve, but also enhance, existing consumer choice. Over the longer term, the Applicants' intention is for both carriers to review costs associated with domestic feeder services, with the objective of reducing those costs to support more competitive pricing.

Rather than reducing capacity or decelerating growth, the Proposed Conduct will also enable the Applicants to add capacity (through aircraft up-gauging and/or increased frequencies) and potentially expand services on to new routes. This is detailed further below. In addition, the Proposed Conduct will elicit a further round of competitive activity among rivals. This is also discussed further below.

As described earlier, alone, Qantas' product offering is not properly aligned to the demand characteristics of the predominantly leisure-focussed customer base in China. By being able to expand its product offering by selling on China Eastern services, Qantas will be better placed to meet

⁹⁵ Ibid, p 1.

⁹⁶ Ibid, p 4.

the demands of inbound leisure travellers visiting Australia and therefore compete against China Southern and other competitors. Similarly, by drawing on Qantas' product and service expertise in addition to sales and distribution capability within Australia, China Eastern will be able to attract and retain increased numbers of premium passengers. The Proposed Conduct will therefore bring together two complementary business models and customer bases – while retaining brand, product and pricing differences.

The Proposed Conduct is also pro-competitive given that, without it, Qantas is likely to become increasingly marginalised in respect of the Australia-China market. Alone, Qantas will not be able to keep pace with the capacity growth being driven by carriers such as China Southern, which will inhibit its ability to effectively compete against them.

7 PUBLIC BENEFITS

7.1 Overview

In determining whether conduct should be authorised under the *Competition and Consumer Act 2010* (Cth) (**Act**), the Commission will apply the 'future with-and-without test' established by the Australian Competition Tribunal to identify and weigh the public benefit and public detriment generated by conduct for which authorisation has been sought. Under this test, the Commission 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.

Public benefit is not defined in the Act. However, the Tribunal has stated that the term should be given its widest possible meaning. It specifically 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.'*⁹⁷

The Tribunal has accepted a 'total welfare standard' test as the most appropriate measure of public benefit under the Act. The total welfare standard recognises that cost savings and efficiencies that accrue to private firms are relevant:

'It follows that cost savings achieved by a firm in the course of providing goods or services to members of the public are a public benefit which can and should be taken into account for the purposes of s90 of the Act, where they result in pass through which reduces prices to final consumers, or in other benefits, for example, by way of dividends to a range of shareholders or being returned to the firm for future investment. However, the weight that should be accorded to such cost savings may vary depending upon who takes advantage of them and the time period over which the benefits are received.'

Our reference to, and adoption of, a total welfare standard - subject to a caveat regarding the weight to be given to public benefits to the extent to which they are not shared among members of the community generally - should not be seen as a new development in the jurisprudence of authorisation. The expression is no more than an economic label describing an analytical tool for determining net public benefit. It may be that this expression has not been explicitly used by tribunals and courts during the history of Australian authorisation decisions. Nevertheless, the doctrine and principles which it represents may be found consistently in the decisions to which we have referred, commencing with QCMA, and it is an

⁹⁷ *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.

*appropriate standard to use given the objects sought by the Act and the language employed in the relevant legislative provisions relating to authorisation.*⁹⁸

The Tribunal has also acknowledged that when a limited public detriment is found, a substantial public benefit is not required to outweigh such detriment.⁹⁹

The Proposed Conduct is inherently pro-competitive. It will:

- a) deliver shorter journey times, improved connectivity and increased schedule choice for passengers flying from Australia to destinations within China, as a result of reduced transit times in Shanghai;
- b) result in improved products and services for customers travelling through Shanghai as a result of improved lounge facilities and coordinated customer service;
- c) facilitate capacity increases through aircraft up-gauging and increased frequencies, while also providing the basis for exploring opportunities to introduce new direct services between Australia and China (namely between Brisbane and/or Perth and Shanghai);
- d) provide enhanced benefits for members of both Applicants' frequent flyer programs, particularly through increased earning and redemption opportunities;
- e) lead to improved reciprocal inventory access and inventory management, leading to a greater availability and variety of price points for consumers;
- f) elicit a pro-competitive response from rival carriers, in particular China Southern and Sichuan Airlines, as well as from hubs competing with Shanghai to attract Australian transit passengers;
- g) promote increased tourism in Australia, increased employment in Australia and enhanced international trade opportunities for Australian businesses; and
- h) expedite the growth of China Eastern in Australia, leading to further employment in Australia and other economic benefits.

Such benefits will not be achievable in the counterfactual position, in which the status quo (being the limited codeshare relationship) is maintained. For example, without the Proposed Conduct, the Applicants have no commercial incentive to co-locate terminals in Shanghai nor to provide enhanced reciprocal frequent flyer benefits.

Taken together, these benefits demonstrate that the test for assessing public benefit – based on the total welfare standard adopted by Tribunal – is satisfied, particularly in circumstances where there is such minimal operating overlap and therefore limited public detriment.

7.2 Shorter Journey Times, Improved Connectivity and Increased Schedule Choice

The Proposed Conduct will result in co-location of Qantas and China Eastern operations in Terminal 1 at Shanghai Pudong Airport. This will deliver significant public benefits.

Qantas' existing Sydney-Shanghai service arrives and departs at Terminal 2 in Shanghai. China Eastern is exclusively based at Terminal 1, both for operations from Australia and domestic operations within China. Currently, passengers connecting between Qantas and China Eastern operations in Shanghai are required to collect checked-in baggage, clear customs and proceed to transfer shuttles to move between Terminal 1 and Terminal 2. To facilitate this connection, a lengthy

⁹⁸ *Re Qantas Airways Limited*, paras 189-190.

⁹⁹ *Ibid*, para 647.

Minimum Connecting Time (**MCT**) of 2 hours 30 minutes is required to support the transfer process to ensure passengers have sufficient time to present for the onward connections.

By contrast, passengers travelling from Hong Kong to onward destinations in mainland China experience only a 60 minute MCT, as a result of seamless and customs-free passenger and baggage transfer arrangements. Currently, this means that Qantas passengers bound for onward destinations in mainland China experience different total journey times depending on whether they transit in Hong Kong or Shanghai. For example:

- a) Qantas passengers travelling from Sydney to Beijing have a total journey time of 13 hours 45 minutes if they transit through Hong Kong or a total journey time of 15 hours 50 minutes if they transit through Shanghai. The direct service between Sydney and Beijing offered by Air China is faster than both transit options, with a total journey time of only 11 hours 50 minutes;
- b) Qantas passengers travelling from Sydney to Chengdu have a total journey time of 13 hours 40 minutes if they transit through Hong Kong or a total journey time of 16 hours 5 minutes if they transit through Shanghai. The service offered by Sichuan Airlines from Sydney to Chengdu via Chongqing has a total journey time of 13 hours 50 minutes, which is still faster than Qantas' current connections via Shanghai; and
- c) Qantas passengers travelling from Sydney to Fuzhou have a total journey time of 13 hours 30 minutes if they transit through Hong Kong or a total journey time of 15 hours 35 minutes if they transit through Shanghai. The service offered by China Southern from Sydney to Fuzhou via Guangzhou is quicker than both Qantas' current transit options, being a total of 13 hours 25 minutes.

Co-location with China Eastern in Terminal 1 in Shanghai, which would only occur as a result of the Proposed Conduct, will remove the requirement for passengers to transfer between terminals, enabling the MCT to be significantly reduced by one hour to 1 hour 30 minutes.

As a result, Qantas passengers will have unprecedented access to a far bigger range of one-stop same-day connections using China Eastern's broad range of services from Shanghai. Some key additional connection options include services from Shanghai to Chengdu, Dalian, Beijing and Xian.

Based on the Applicants' Northern Winter 2014 schedules, terminal co-location would enable Qantas passengers to have access to 56 additional frequencies to 9 destinations.

Table 5: Increased Connection Frequencies

For Qantas Passengers Travelling Between Shanghai and Mainland China

Itinerary	Number of Current Connection Options	Number of Connection Options Available Through Proposed Conduct
Shanghai – Dalian	7	21
Shanghai – Beijing	7	12
Shanghai – Chengdu	7	14
Shanghai – Xian	14	21
Shanghai – Harbin	0	7
Shanghai – Yanji	0	7
Shanghai – Xining	5	10
Shanghai – Nanchong	0	3
Shanghai – Nanchang	0	1

Note: Based on the Applicants' schedules as filed for the Northern Winter 2014 season. Flights will be considered to have a valid connection for this purpose if they depart within 4 hours of the arrival flight.

As a result of the Proposed Conduct, Qantas passengers will be able to achieve significantly reduced travel times. For example, currently travel time for Qantas passengers from Sydney to Beijing is approximately 15 hours 50 minutes (including a 4 hour 10 minute connection in Shanghai). However, as a result of the Proposed Conduct, the total travel time for Qantas passengers will be reduced by 2 hours 10 minutes, to 13 hours 40 minutes. This offers a closer competitive alternative to the travel time offered through Cathay Pacific services (of 13 hours 45 minutes), although China Airlines would continue to offer an even faster journey time through their direct service of 11 hours 50 minutes.

The ability to discuss and coordinate operations would also facilitate schedule optimisation. The Applicants intend to identify opportunities to deliver customers broader choice of departure and arrival times throughout the day, enabling greater choice of onward flight connections. During the Northern Winter 2014 season, for instance, Qantas and China Eastern services departed at close intervals as set out in Table 6 below.

Table 6: Schedules – Sydney-Shanghai, Northern Winter 2014

Operating Carrier	Current Schedule
Qantas	Dep SYD 1050 Arr PVG 1830
China Eastern	Dep SYD 1200 Arr PVG 1920
Qantas	Dep PVG 2005 Arr SYD 0940
China Eastern	Dep PVG 2020 Arr SYD 1000

As a result of the Proposed Conduct, the intention would be to further differentiate arrival and departure times in future. Potential options for future scheduling may enable both morning *and* evening departures in both Sydney and Shanghai, providing customers with greater choice and flexibility of flight times.

The reduced transit times and enhanced connectivity will also deliver benefits to freight customers, particularly those who ship time-sensitive freight such as perishable items. This will be a particular benefit given the forecast increase in demand in China for chilled milk and Australian beef.

7.3 Improved Product and Services

Terminal 1 co-location will also mean that Qantas and China Eastern will share enhanced lounge facilities, providing customers with a consistent, high standard of product, to enable more effective management of customers who are transferring between Qantas and China Eastern operations. Currently, the lounge which Qantas passengers must use in Shanghai is of inferior quality to that which would be available by sharing with China Eastern in Terminal 1. The Proposed Conduct would therefore facilitate a real product enhancement because the lounge is new and features more modern facilities, menu choice and space.

Customer experience will be enhanced with consistent service offerings for ground handling, including flight check-in, gate arrival and departure services, transfer counters, customer services counters and catering and ramp services. Co-location would enable the Applicants to provide more timely and effective customer servicing, with use of centralised support desks and transfer counters.

In respect of coordinated freight services, the Proposed Conduct will also facilitate streamlined customs duty processes and remove the need for repackaging and relabeling of freight as it will be transported via one combined network.

7.4 Facilitation of Capacity Increases

The Proposed Conduct will enable the Applicants to offer new services (including but not limited to increased frequencies) that would otherwise not be offered or not be offered as quickly. For example, as a result of the Proposed Conduct (specifically, being able to utilise combined load volumes) the Applicants expect that China Eastern will, in 2016, be able to offer additional frequencies on existing routes. This would result in China Eastern operating 24 flights per week between Sydney and Shanghai and 22 flights per week between Melbourne and Shanghai.

In addition, the Proposed Conduct will provide the basis for the Applicants to explore opportunities to introduce services on new routes, namely between Brisbane and/or Perth and Shanghai. These potential opportunities would be a material and direct result of the Proposed Conduct. In September 2014, Brisbane Airport Corporation signed a Memorandum of Understanding with Shanghai Pudong Airport designed to facilitate such capacity expansion and encourage more Chinese visitors. For instance, Brisbane Airport will feature signage with Mandarin translations and provide culturally appropriate food and beverage options to cater for Chinese visitors.¹⁰⁰

The Commission has previously acknowledged that the introduction of new direct services gives rise to public benefits through increased choice and convenience arising out of reduced travel time and that new routes may stimulate market growth.¹⁰¹

7.5 Enhanced Frequent Flyer Benefits

The Proposed Conduct will result in members of both Applicants' frequent flyer programs having increased opportunities to earn and redeem points on the respective networks. Currently, there are limited earn opportunities and very limited redemption activity. The Proposed Conduct provides the commercial incentive to improve this proposition.

Qantas will offer other privileges, such as increased baggage allowances, to China Eastern passengers who travel on Qantas services. This is a benefit that again would not be extended in the absence of the Proposed Conduct.

7.6 Improved Reciprocal Inventory Access and Inventory Management

The Proposed Conduct will result in the transition of the existing block space arrangements under the Current Codeshare Agreement, as they apply to Qantas operated Sydney-Shanghai services and China Eastern operated Melbourne-Shanghai services, to a freesale codeshare. The Current Codeshare Agreement does not include Qantas codesharing on China Eastern's Sydney-Shanghai service, but as a result of the Proposed Conduct this service will be part of the freesale arrangement.

This will enable each carrier to have unlimited access to seats operated by the other. Customer choice will be enhanced because each carrier can access all available inventory. In other words, both carriers will have access to the complete range of commercial fare types and all available seats on the aircraft. In practical terms, this will result in both carriers being able to sell a broader range of price points and more seats than is currently the case.

It is also expected that the reciprocal inventory access will mean that in cases where one carrier's loads are not full in the lead up to a departing service, the other carrier will be able to stimulate demand through discounted price points to help fill that capacity. The travelling public will benefit from this coordinated ability to optimise capacity through such inventory management.

¹⁰⁰ 'Chinese drive new look in airports' in *Courier Mail* 17 September 2014.

¹⁰¹ See for example: Singapore Airlines/Virgin Australia Determination, paras 4.37-4.44; Etihad/Virgin Australia Determination, paras 4.27-4.46.

Inventory management will also facilitate public benefits by enabling better servicing of group bookings. The Australia-China market is characterised by a high prevalence of group bookings, typically student and tour groups. For example, Qantas estimates that group bookings account for up to 20% of its passenger volumes between Sydney and Shanghai. Currently, where Qantas does not have sufficient capacity to book a group on its own services, system constraints prevent Qantas being able to book these passengers as Qantas codeshare passengers on China Eastern services. The result is that the group business is lost to other carriers or otherwise denied travel on their selected dates. As a result of the Proposed Conduct, both carriers will have greater ability to offer more seats to such groups and coordinate management of groups between Qantas and China Eastern operations.

7.7 Competitive Response From Rivals

As mentioned earlier, the Proposed Conduct will provoke more competitive fares and product/service offerings from rival carriers. The Applicants expect a strong and swift reaction to the Proposed Conduct from competitors, particularly China Southern and Air China.

Existing competition between carriers and hub ports will continue once the Proposed Conduct commences. The dynamic growth by these major carriers, as outlined above, shows that they will be able to swiftly respond to the Proposed Conduct with their own competitive offering. Each percentage of passenger share lost to a competing carrier or competing hub has significant profit implications. Accordingly, the Proposed Conduct will elicit a strong, pro-competitive response from these carriers, who will fight to retain and gain passenger share that might otherwise be gained by the Applicants' new ability to offer improved services across a wider network at sustainably competitive prices. This will result in more efficient, better quality and lower priced services.

The rivalrous behaviour in the airline industry and the likelihood that cooperation will trigger a competitive response from other carriers, has been recognised by the Commission in its recent decisions. For example, the Commission confirmed the relevance of 'game theory' within international aviation markets in assessing the Singapore Airlines/Virgin Australia alliance in 2011, when it stated that:

Generally the ACCC considers that aviation alliances can stimulate competitive responses amongst rivals in the international air passenger transport services market(s) 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).

This sentiment was repeated in more recent determinations in respect of Etihad/airberlin and the Star Alliance corporate dealing arrangements. In respect of the latter, the Commission again stated that:

'The ACCC considers that the enhanced service offering of Star Alliance members under the Programs has the potential to trigger a competitive response from Qantas (and its oneworld alliance partners)....'

As the Tribunal has acknowledged, competition for the marginal passenger is likely to spread to the benefit of the entire passenger base:

'The competition for the customer at the margin does not stay with that customer, but those fares necessary to attract the marginal customer will be available to all buyers in the market. The competition for an extra 1% of market share has an advantage and benefit for all passengers who are within a similar passenger profile as the marginal passengers. All customers have the ability to get the same advantage and benefit. Therefore, the competition for the marginal passenger spreads throughout the market.'

In addition to stimulating carrier responses, the Proposed Conduct will also generate increased competition between hubs. By focussing and facilitating new investment by Qantas in Shanghai, the Proposed Conduct will spur innovative responses from other ports such as Hong Kong, Beijing, Guangzhou, Chengdu, Fuzhou, Singapore and Kuala Lumpur.

Competition between hubs has intensified, given the wide ranging and substantial economic benefits that flow from hub connectivity. The use of longer haul aircraft has also meant that hub competition spans a wider geographic area.¹⁰² Hub competitiveness is driven by frequency of connections, price and service quality.¹⁰³ To attract carriers, hubs compete not just on their geographic location, which defines flight times for passengers, but also in respect of offering liberal open skies policies, competitive landing charges and quality infrastructure that moves people and luggage efficiently and quickly. To attract passengers, hubs compete by offering improved customer experiences, such as lounges, shopping and eating facilities at airports as well as being sought-after destinations in their own right for stop over traffic.

Airports actively compete to attract more through-traffic. For example, Singapore Airlines and Changi Airport work directly with tourism bodies within Australia to attract passengers from Australia to Singapore, whether as a destination in itself or as a stopover enroute elsewhere. Changi Airport has announced plans for a \$1.5 billion upgrade to its facilities, including retail shops, leisure attractions and a communal complex.¹⁰⁴ Changi Airport already offers 'hop on hop off' facilities to improve the experience for transit passengers and offers a free city tour to transit passengers who have a stopover of five hours or more. Kuala Lumpur Airport offers similar services. Within China itself, it is also expected that competing hubs like Beijing and Guangzhou will also continue to innovate to attract transit passengers. Several Chinese ports already offer transit passengers the opportunity to stay in China on a visa-free basis for certain periods – in Shanghai, for instance, transit passengers can stay without a visa for up to 72 hours.

Australian consumers will be the direct beneficiaries of this intensified competition.

7.8 Increased Tourism

The Proposed Conduct will generate increased numbers of inbound travellers to Australia. By engaging in joint advertising campaigns to leverage Qantas' overseas profile and China Eastern's significant sales and marketing presence in China, the Applicants expect inbound tourism to Australia to increase considerably as a direct result of the Proposed Conduct.

Short term visitors from China have tripled in the last decade – in 2013-2014, there were almost 770,000 arrivals making it the second most popular source of visitors behind New Zealand.¹⁰⁵ Importantly, Chinese tourists stay the longest and spend the most (\$5.1 billion in the year to March 2014).¹⁰⁶ It has been predicted that Chinese tourists will spend \$13 billion per year in Australia by 2020.¹⁰⁷ As set out earlier in this submission, it is estimated that China alone will be responsible for 24% of all inbound tourism growth and 40% of all income derived from the inbound market in the period from 2012-2013 to 2022-2023.¹⁰⁸

The tourism industry is an important part of the Australian economy, contributing the equivalent of over \$115 million a day to the Australian economy in 2012-2013.¹⁰⁹ Airline services are a significant contributor to the tourism value chain. Qantas is synonymous with its Australian home market and invests heavily in promoting Australia as an inbound tourism destination for international tourists. In

¹⁰² 'Dubai overtakes Singapore in passenger volume' 29 February 2012. Available: <http://airlinesairports.wordpress.com/2012/02/29/dubai-overtakes-singapore-changi-in-passenger-volume> (Accessed 22 August 2014)

¹⁰³ 'Hub competitiveness in a changing world' in *Open Sky The Public Affairs Journal of Emirates*, Issue 11, October 2011, p 4. Available: http://content.emirates.com/downloads/ek/pdfs/open_sky/Oct2011.pdf (Accessed 22 August 2014)

¹⁰⁴ 'Bio dome for Changi Airport' in *Travel Daily* 7 August 2014.

¹⁰⁵ 'China leading arrivals growth' in *Travel Daily* 7 August 2014.

¹⁰⁶ Tourism Australia data cited in 'Time to roll out the red carpet' in *The Australian* 12 August 2014, p 28.

¹⁰⁷ Tourism Australia data cited in 'Chinese visitors eclipsing Kiwis' in *Australian Financial Review*, 11 September 2014.

Available: http://www.afr.com/p/special_reports/asia_trade/chinese_visitors_eclipsing_kiwis_fMQHShnl61oSBFHUB1yZJO (Accessed 16 September 2014).

¹⁰⁸ Tourism Research Australia Forecasts, Autumn 2014, p 28. Available:

http://www.tra.gov.au/documents/forecasts/Tourism_Forecasts_Autumn_2014_FINAL_18062014.pdf (Accessed 6 October 2014).

¹⁰⁹ *Australian National Accounts: Tourism Satellite Account*, Australian Bureau of Statistics, 2012-2013. Available:

<http://www.abs.gov.au/ausstats/abs@.nsf/mf/5249.0?OpenDocument> (Accessed 22 August 2014).

the past decade, Qantas has spent more than \$100 million on marketing and advertising to attract international visitors to Australia.

China Eastern has also played an important role in stimulating inbound tourism to Australia. Since 2012, China Eastern has been working to implement activities to promote tourism to Australia on China Eastern's services using the 'There's Nothing Like Australia' campaign.

The Asia Marketing Fund, announced by the Australian Government in the 2012-2013 Budget, provides A\$48.5 million over four years to promote Australia as a tourism destination to the growing markets of Asia. China is Australia's most valuable inbound tourism market –in 2010, the China inbound market contributed \$3.26 billion to the Australian economy; by 2020, this market has the potential to contribute \$7 to \$9 billion annually.¹¹⁰ In July 2014, Tourism Australia announced a new strategy aimed at attracting more Chinese visitors to Australia, using specialist travel agencies and a new advertising campaign to promote high quality Australian holiday packages to the rapidly growing middle class in China.¹¹¹ Tourism Australia confirmed that working to 'increase flights and improve aviation access' was a part of this strategy.

With the additional traffic the Proposed Conduct should stimulate, combined overall contribution to passenger numbers will increase. This will have important spill over effects within the wider Australian economy, particularly by generating more employment within the tourism sector. The tourism industry accounts for 4.7% of total employed persons in the Australian economy; in 2012-2013, the Australian tourism industry employed 543,600 persons.¹¹² It has been estimated that forecast growth in air traffic volumes at Sydney Airport will increase from 283,700 jobs in 2012 to over 400,000 by 2033, whilst generating or facilitating economic activity valued at \$27.6 billion in 2012 to over \$42 billion in 2033.¹¹³ This kind of growth would be accelerated and enhanced by the Proposed Conduct.

7.9 Promotion Of International Trade And Business

The Proposed Conduct will strengthen the bilateral relationship between Australia and China. The Australian Government is currently negotiating an Australia-China Fair Trade Agreement (FTA), which in turn will encourage new Chinese investors to invest in sectors such as infrastructure and agriculture, promoting tourism and building linkages in agricultural research. The current Australian Government's top trade policy priority is to conclude this FTA. The Department of Foreign Affairs and Trade (DFAT) has stated that:

'Concluding the FTA will provide extensive opportunities to Australian businesses, removing barriers to trade with our biggest market for services, resources and agriculture. Australia's economy could benefit from higher Chinese investment as a result of the FTA, increasing our productive capacity in areas such as resources and agriculture.'

Australian services firms including in financial, consulting, legal, education and telecommunications sectors, could benefit from improved access to the China market and through their role as facilitators of other trade. Importantly, our agricultural exports will benefit from improved competitiveness in areas such as dairy, horticulture, meat and wine.'

*The Government has been promoting its open investment regime and Foreign Investment Review Board process, which continues to attract Chinese investors. The stock of Chinese investment in Australia is now more than fourteen times the level it was in 2005 at \$31.9 billion, with new investments of \$8.8 billion in 2013.'*¹¹⁴

¹¹⁰ See Tourism Australia Strategic Plan (Accessed 30 July 2014) Available:

http://www.tourism.australia.com/documents/Markets/China2020_Strategic_Plan.pdf

¹¹¹ See 'Tourism Australia targets China FIT market with new distribution strategy' (Accessed 30 July 2014). Available:

<http://www.tourism.australia.com/markets/market-regions-greater-china-China-FIT-market-new-strategy.aspx>

¹¹² Australian National Accounts: Tourism Satellite Account, Australian Bureau of Statistics – 2012-2013. Available:

<http://www.abs.gov.au/ausstats/abs@.nsf/mf/5249.0?OpenDocument> (Accessed 15 August 2014).

¹¹³ See Sydney Airport Corporation Limited 'A Major Employer and Economic Driver' Available:

<http://www.sydneyairport.com.au/corporate/master-plan/fact-sheets/a-major-employer-and-economic-driver.aspx> (Accessed 15 August 2014).

¹¹⁴ DFAT Country Brief Available: http://dfat.gov.au/geo/china/china_brief.html (Accessed 29 July 2014).

The Proposed Conduct will enable Australian exporters to more readily access the Applicants' combined network and significantly increase international trade opportunities for Australia.

Increasing numbers of Australian businesses are entering the Chinese market.¹¹⁵ All of these businesses will directly benefit from the Proposed Conduct due to improved and increased services between Australia and China. In 2012, freight traffic to, from and within China was estimated to account for 15% of the global air freight services market and it has been projected that this will increase to 20% by 2032.¹¹⁶ By granting Australian exporters improved access to China Eastern's expansive network, the Proposed Conduct will deliver a significant increase in international trade opportunities for Australians, together with increased supply chain certainty.

7.10 Economic Benefits From Expedited China Eastern Growth in Australia

The Proposed Conduct will strengthen and expedite the platform for China Eastern's capacity growth in Australia. China Eastern has already made a substantial contribution to the Australian economy since it first commenced services to Australia.

The Proposed Conduct will further incentivise China Eastern to grow and invest in Australia and this will directly lead to more benefits sooner for Australia and Australian consumers (including increased employment opportunities in Australia). In framing the terms of the Joint Coordination Agreement, the Applicants have been clear to ensure that the coordination will in no way restrain or inhibit China Eastern's ability to expand in Australia.

In addition, as a result of the Proposed Conduct, China Eastern will actively promote secondary cities within Australia, particularly in domestic China, where Qantas has limited reach today. This additional capability will be key for developing corporate business opportunities for Australian secondary cities.

8 TERM OF AUTHORISATION

The Applicants seek authorisation for the Proposed Conduct for 5 years. This time frame is consistent with other authorisations granted in the aviation industry.

¹¹⁵ DFAT Country Brief Available: http://dfat.gov.au/geo/china/china_brief.html (Accessed 29 July 2014).

¹¹⁶ Airbus Global Market Forecast 2013-2032. Available: http://www.airbus.com/company/market/forecast/?eID=dam_frontend_push&docID=33752 (Accessed 22 August 2014).

CONFIDENTIAL ANNEXURE A – JOINT COORDINATION AGREEMENT

[CONFIDENTIAL – REDACTED FOR PUBLIC VERSION]

ANNEXURE B – QANTAS ROUTE MAP



Location of The Qantas Clubs or associated lounges
Qantas Routes

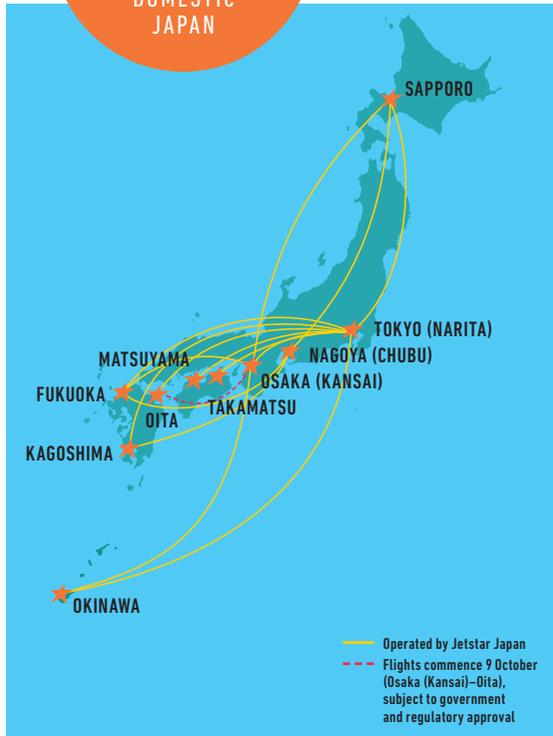
Content correct as of February 2014
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ANNEXURE C – JETSTAR ROUTE MAP

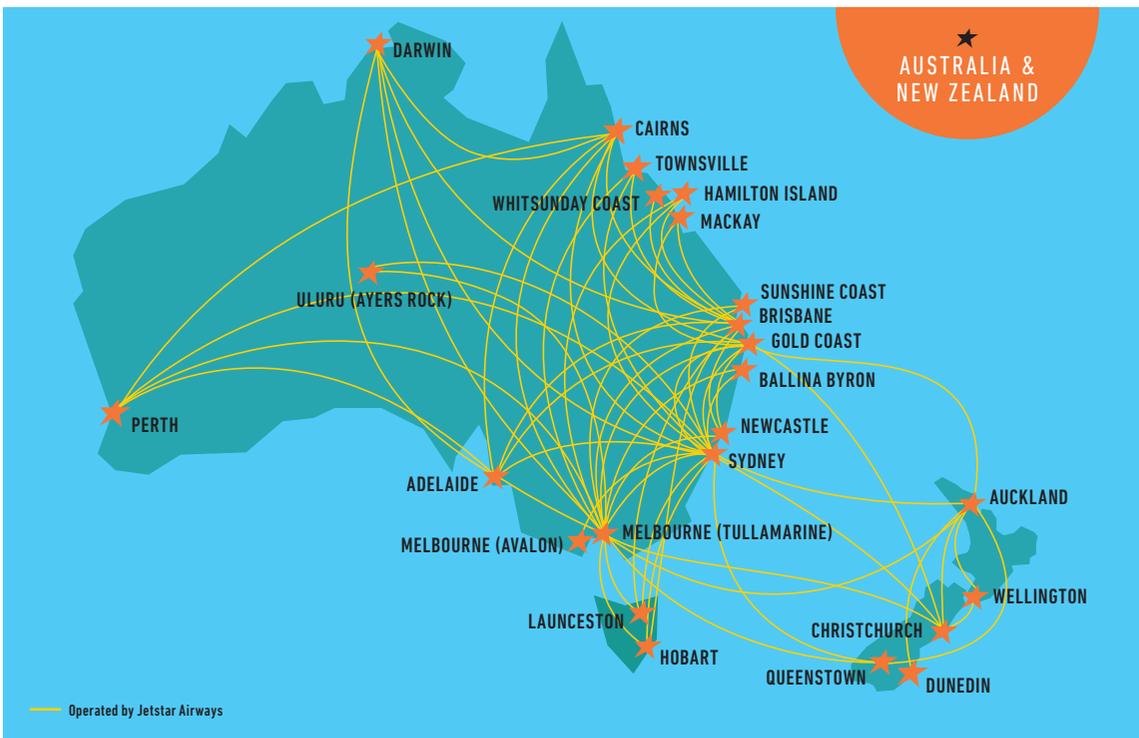
★
DOMESTIC
VIETNAM



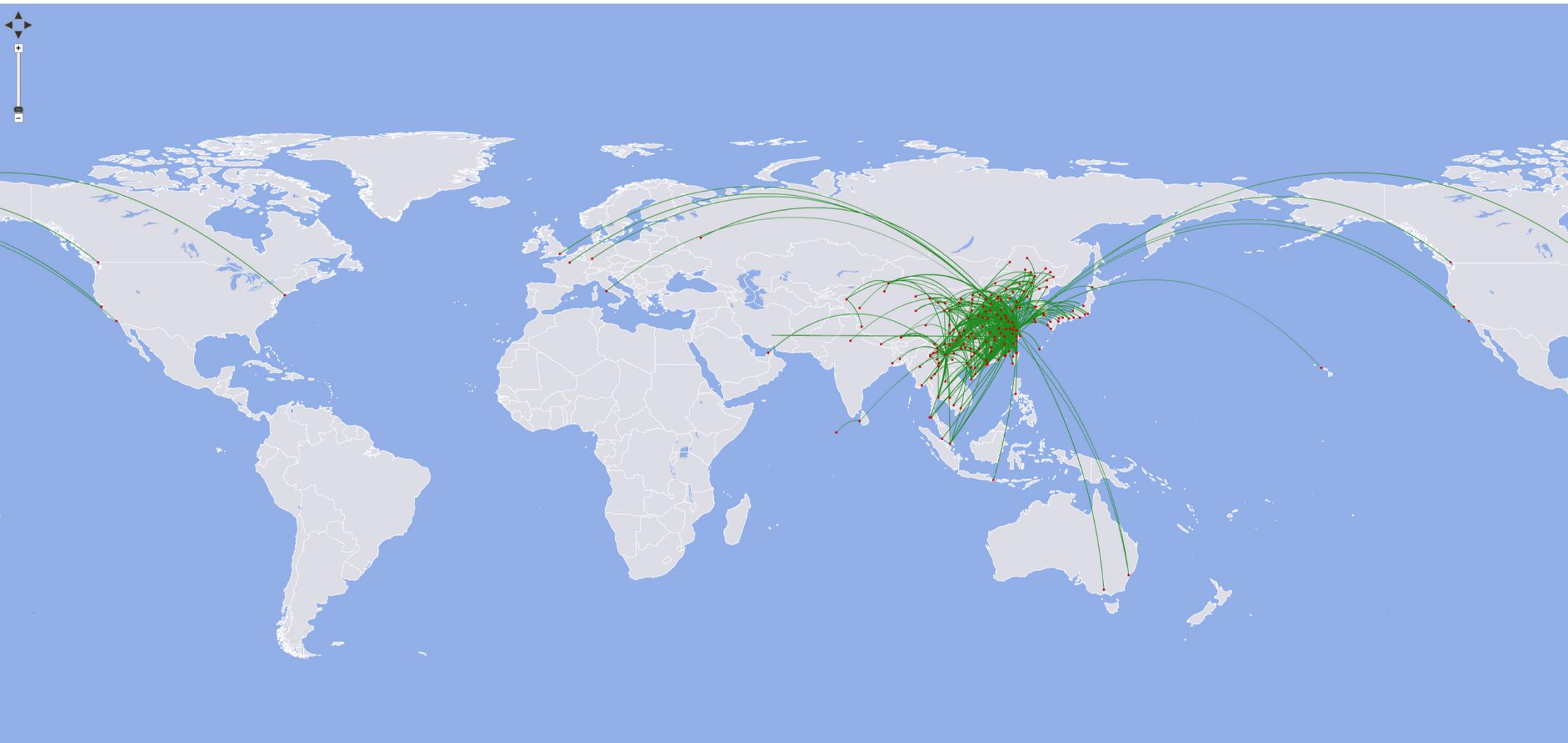
★
DOMESTIC
JAPAN



★
AUSTRALIA &
NEW ZEALAND



ANNEXURE D – CHINA EASTERN ROUTE MAP



ANNEXURE E – AUSTRALIA-CHINA MARKET GROWTH

Table 1: Total Australia-China Market Growth (Inbound and Outbound Passengers)

Period	Total Passenger Numbers	Annual Growth
May 2009-April 2010	1,492,267	-
May 2010-April 2011	1,851,573	24%
May 2011-April 2012	2,081,700	12%
May 2012-April 2013	2,291,002	10%
May 2013-April 2014	2,510,999	10%
Average Growth Rate		11%

Source: ABS

ANNEXURE F – PASSENGER MARKET SHARE DATA

Table 1: Australia-China Capacity and Passenger Share By Carrier, 1 July 2013-30 June 2014

Carrier	Total Seats	Total Capacity Share %	Total Passengers	Total Passenger Share %	% Capacity Growth VLY	% Passenger Growth VLY
China Southern	680,680	28.62	494,314	27.20%	1%	3%
China Eastern	462,119	19.43	351,304	19.33%	11%	11%
Cathay Pacific	388,261	16.33	308,966	17.00%	6%	6%
Air China	298,530	12.55	237,728	13.08%	0%	1%
Qantas	234,646	9.87	184,939	10.18%	3%	2%
Singapore Airlines	137,791	5.79	107,724	5.93%	0%	0%
Sichuan Airlines	87,120	3.66	66,117	3.64%	189%	194%
Malaysia Airlines	43,477	1.83	31,672	1.74%	48%	50%
Korean Airlines	13,551	0.57	10,260	0.56%	-33%	-31%
Thai Airways	5,942	0.25	4,482	0.25%	24%	21%
Jetstar	2,197	0.09	1,667	0.09%	14%	15%
Jetstar Asia	685	0.03	513	0.03%	71%	70%

Source: MIDT, June 2014

Table 2: Australia-China Total Passenger Share by Carrier, May 2009-April 2014

Carrier	May 2009-April 2010	May 2010-April 2011	May 2011-April 2012	May 2012-April 2013	May 2013-April 2014
China Southern	11%	18%	23%	22%	22%
China Eastern	10%	11%	12%	15%	14%
Cathay Pacific	23%	19%	17%	18%	17%
Air China	13%	12%	11%	10%	9%
Qantas Group	21%	18%	17%	15%	15%
Singapore Airlines	9%	8%	6%	6%	6%
Sichuan Airlines	0%	0%	0%	0%	0.3%
Malaysia Airlines	1%	2%	1%	1%	2%
Virgin	2%	3%	3%	3%	2%
Emirates	1%	1%	2%	2%	2%
Air New Zealand	1%	1%	1%	1%	1%
China Airlines	1%	0%	1%	2%	2%
Air Asia X	1%	1%	1%	1%	2%
Others	7%	5%	5%	4%	6%
Total	100%	100%	100%	100%	100%

Source: ABS

Table 3: Total Share Of Business Purpose Travellers Australia-China

By Carrier, May 2009-April 2014

Carrier	May 2009-April 2010	May 2010-April 2011	May 2011-April 2012	May 2012-April 2013	May 2013-April 2014
China Southern	6%	12%	14%	16%	18%
China Eastern	6%	7%	8%	9%	9%
Cathay Pacific	27%	27%	26%	26%	26%
Air China	12%	12%	10%	8%	7%
Qantas Group	27%	24%	25%	22%	21%
Singapore Airlines	13%	9%	10%	10%	10%
Malaysia Airlines	1%	2%	1%	2%	2%
Emirates	0%	1%	0%	0%	1%
Air New Zealand	1%	1%	1%	1%	1%
Air Asia X	0%	0%	0%	0%	1%
Others	5%	4%	4%	3%	4%
Total	100%	100%	100%	100%	100%

Source: ABS

Table 4: Total Share Of Leisure Purpose Travellers Australia-China

By Carrier, May 2009-April 2014

Carrier	May 2009-April 2010	May 2010-April 2011	May 2011-April 2012	May 2012-April 2013	May 2013-April 2014
China Southern	12%	19%	24%	23%	22%
China Eastern	11%	13%	14%	16%	15%
Cathay Pacific	20%	16%	14%	14%	14%
Air China	12%	12%	11%	10%	9%
Qantas Group	21%	18%	16%	15%	15%
Singapore Airlines	8%	7%	5%	5%	6%
Virgin	2%	5%	5%	3%	0%
Emirates	1%	1%	2%	3%	2%
China Airlines	1%	0%	1%	2%	2%
Air Asia X	1%	1%	1%	1%	2%
Others	10%	8%	7%	8%	13%
Total	100%	100%	100%	100%	100%

Source: ABS

**Table 5: Total Share of Passengers Sydney to Shanghai
By Carrier, 1 July 2013-30 June 2014**

Carrier	Total Seats	Total Capacity Share %	Total Passengers	Total Passenger Share %
China Eastern	156,674	40.39	118,987	39.54
Qantas	131,345	33.86	103,482	34.38
Air China	56,526	14.57	44,783	14.88
Cathay Pacific	26,485	6.83	20,902	6.95
Singapore Airlines	7,176	1.85	5,591	1.86
Malaysian Airlines	3,901	1.01	2,874	0.95
China Southern	1,376	0.35	1,007	0.33
VN	1,261	0.33	931	0.31
Korean Airlines	576	0.15	432	0.14
OZ	389	0.10	305	0.10
Sichuan Airlines	410	0.11	311	0.10
Jetstar	7	0.00	6	0.00
Jetstar Asia	-	-	-	-

Source: MIDT, June 2014

CONFIDENTIAL ANNEXURE G – FREIGHT MARKET SHARE DATA

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