File Reference:

Dr Richard Chadwick
General Manager
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

Dear Dr Chadwick

Qantas Airways Ltd and China Eastern Airlines Corporation Ltd applications for authorisation

Thank you for your letter of 19 November 2014. The Department of Infrastructure and Regional Development (the Department) appreciates the opportunity to provide a submission to the ACCC on the proposed joint coordination agreement between Qantas and China Eastern.

The Department recognises that it is a matter for the ACCC to determine the relative merits of arguments presented by the applicants on the public benefits and the effect on competition of the proposed joint venture.

To assist the ACCC in coming to a determination in relation to such competition impacts, this submission provides contextual information on the relevant aviation markets, the air service arrangements which underpin it and the Australian Government's aviation policy.

Air service arrangements

As the ACCC is aware, the regulatory framework governing international air services is complex.

While most sectors of international trade operate on the assumption that markets are open unless governments intervene to restrict access, international aviation cannot occur unless governments act to open the market. This action occurs in the form of at least two countries negotiating and signing an air services arrangement, specifying that international air travel can occur between their respective territories. Air services are contrary to most other internationally traded services, as without the cooperation of at least two countries, the product cannot be traded and the market would not exist.

The Department is responsible for negotiating air services arrangements with foreign economies. These bilateral arrangements typically set out the number of flights that airlines of the two countries can operate, cities they can serve in the other country and rights to operate via or beyond to third countries. The arrangements usually also include provisions related to such matters as airline ownership and control, competition law, safety and security.

The International Air Services Commission is responsible for allocating the available capacity negotiated under air services agreements to the Australian airlines that apply to use it.

Our air service arrangements with China are governed by the *Agreement between the Government of Australia and the Government of the People's Republic of China relating to Air Services,* done at Canberra 23 March 2004 [2006] ATS 19 and two Memoranda of Understanding (MoU) between the aeronautical authorities of Australia and China — the MoU signed in Guangzhou on 2 March 2011 and another MoU signed in Beijing on 9 July 2003.

The arrangements with China provide for restricted capacity for airlines of Australia and China between the two countries, with limitations on the traffic rights which can be exercised between and beyond the two countries. The Department is scheduled to conduct further negotiations with Chinese aeronautical authorities early in the first quarter of 2015.

Status of the market

China is Australia's fourth largest international market, with origin/destination traffic of over 2.5 million passengers in the year ended September 2014. Annual growth in the Australia-China market has averaged 13.1 per cent over the past five years (2009-2014) and 11.3 per cent over the last 10 years (2004-2014).

Five airlines currently operate direct services between Australia and China – Qantas, Air China, China Eastern, China Southern and Sichuan Airlines. The table at Attachment A provides a five year overview of the market share of passengers flying on direct services between Australia and China.

The Australia-China market is also serviced by a large number of one-stop options. Historically, these one stop options have predominantly been provided by Cathay Pacific and Singapore Airlines. The table at Attachment B provides a five year overview of origin/destination traffic between Australia and China.

Airline partnerships and global trends

Consolidation, cooperative arrangements, alliances and other inter-airline agreements have been a consistent feature of the international airline industry over the last 10 years. These partnerships have moved beyond more traditional group alliances such as Oneworld and the Star Alliance. Alliances and partnerships now include measures for airlines to co-operate in matters such as scheduling, shared use of airport facilities, marketing and frequent flyer programs.

These partnerships are important for the sustainability of Australian based airlines. Whilst Qantas has been able to maintain a consistent level of overall origin/destination traffic in the Australia-China market, the growth of other carriers in the market has meant its market share has fallen from 18.9 per cent in 2010 to 12.4 per cent in 2014, as shown in Attachment B.

Partnerships with foreign airlines allow Qantas and other Australian carriers to expand their presence and/or improve their product offering in these markets with limited capital expenditure.

The Department is generally supportive of any proposals which enhance the sustainability of a viable Australian aviation industry subject to compliance with competition laws. Consistent with this approach the Department has been supportive of the recent alliances between Qantas and Emirates and those between Virgin Australia and Etihad, Air New Zealand, Singapore Airlines and Delta Air Lines.

The Australian Government's policy and regulatory settings

The Australian Government is committed to helping the aviation industry grow in an environment that is safe, competitive and productive.

This includes providing improved opportunities for Australian carriers to access international markets and increasing competition and choice for Australian foreign travellers on international routes to and from Australia.

The proposed coordination agreement is, in the Department's view, compatible with these objectives.

The agreement would build upon the codeshare arrangements Qantas currently has with China Eastern. It would extend the arrangements to co-ordination of schedules, passenger sales, marketing and use of airport facilities (including airport lounges).

In our view, the agreement would benefit Australian consumers by allowing Qantas to offer its customers better access to destinations within China as well as improving connection times for onwards flights from Shanghai. It would also result in added benefits by boosting Australia's tourism industry through increasing the ability for both airlines to market and sell tickets to Australian destinations.

The Department expects the proposed coordination agreement would have a limited impact on competition. Based on the 2014 origin/destination figures for traffic between Australia and China, Qantas and China Eastern would only have a combined market share of 25.6 per cent. Clearly, there are significant competitive forces in the Australia-China market and we would expect these forces would be able to negate the potential of any anti-competitive conduct by any airlines in the market.

Thank you again for inviting the Department to provide a submission. I can be contacted on [redacted] should you wish to discuss this matter further or require any additional information.

Yours sincerely

Stephen Borthwick

Stephen Borthwick
General Manager
Aviation Industry Policy Branch
18 December 2014

Att. A

International Scheduled Air Transport - data supplied by airlines
Uplift/Discharge within single flight number services
Australia - China
Years ended September

Scheduled Operator	2010	2011	2012	2013	2014	Share
China Southern Airlines	214,886	465,297	615,994	691,717	731,635	44.4%
China Eastern Airlines	198,250	263,894	322,538	413,888	397,618	24.2%
Air China	252,213	284,915	291,253	301,461	286,221	17.4%
Qantas Airways	142,408	141,547	141,135	148,639	156,088	9.5%
Sichuan Airlines				19,891	74,553	4.5%
Jetstar			3,930	1,250	58	0.0%
Hainan Airlines		22,337	17,169			
Total	807,757	1,177,990	1,392,019	1,576,846	1,646,173	100.0%

Att. B

TABLE 4 O/Ds FOR AUSTRALIA - CHINA U/D TRAFFIC

	Year ended September									
Origin/Destination	**2010**	**%**	**2011**	**%**	**2012**	**%**	**2013**	**%**	**2014**	**%**
China	917 608	84.2%	1 189 915	83.6%	1 341 489	80.3%	1 495 839	79.9%	1 638 771	82.0%
United Kingdom	22 459	2.1%	26 420	1.9%	41 430	2.5%	51 601	2.8%	50 985	2.6%
France	11 905	1.1%	14 922	1.0%	24 133	1.4%	30 814	1.6%	29 668	1.5%
United States of America	10 952	1.0%	14 223	1.0%	24 834	1.5%	27 334	1.5%	28 013	1.4%
Taiwan	9 245	0.8%	11 961	0.8%	15 816	0.9%	15 441	0.8%	19 765	1.0%
Hong Kong	9 830	0.9%	12 677	0.9%	15 618	0.9%	13 597	0.7%	19 435	1.0%
Germany	13 063	1.2%	15 524	1.1%	18 062	1.1%	18 038	1.0%	17 699	0.9%
Canada	4 895	0.4%	7 857	0.6%	13 044	0.8%	12 730	0.7%	17 579	0.9%
Japan	6 457	0.6%	9 521	0.7%	15 234	0.9%	17 959	1.0%	17 141	0.9%
Korea (South)	3 723	0.3%	9 731	0.7%	14 858	0.9%	16 807	0.9%	13 180	0.7%
Other	80 050	7.3%	109 799	7.7%	145 077	8.7%	173 093	9.2%	146 584	7.3%
Total	1 090 188	100.0%	1 422 550	100.0%	1 669 594	100.0%	1 873 252	100.0%	1 998 818	100.0%

Note that the visitor's country of residence will be recorded as the O/D country for those visitors undertaking side trips from Australia.
Australian Passenger Card data - DIBP/DIRD