



PUBLIC REGISTER VERSION

**QANTAS AND CHINA EASTERN JOINT COORDINATION AGREEMENT,
AUTHORISATION NUMBERS A91470 AND A91471**

We refer to the Commission's 23 July 2015 request for further information in respect of how the proposed new routes and frequencies outlined in the Applicants' submission on 20 July 2015 (Proposed Capacity) are contingent on, or will be facilitated by, the Proposed Conduct.

The Proposed Conduct will:

- incentivise and expedite capacity growth that would not otherwise occur or would not occur as quickly; and
- enable that capacity growth to be more sustainable, leading to a higher likelihood of further expansion,

thereby delivering public benefits that outweigh any competitive detriment.

As the Commission is aware, without the Proposed Conduct:

- the Applicants have *no* commercial incentive to:
 - share the risk and expedite sustainable capacity expansion to Australia;
 - expand the range of destinations to which the codeshare applies;
 - expand the range of inventory available for sale to the other carrier;
 - work together to improve connectivity and schedule choice;
 - co-locate terminals in Shanghai;
 - enhance reciprocal frequent flyer benefits and improve access to redemption opportunities;
 - leverage sales and distribution opportunities to maximise brand and service awareness in each other's home markets;
- China Eastern has less incentive to direct and expedite fleet expansion to Australian routes; and
- Qantas becomes increasingly marginalised on Australia-China routes, making its operations less sustainable.

The Proposed Capacity is higher than historic CAGR on Australia-Shanghai Routes

The Commission's concern with the Proposed Conduct is that it will give Qantas and China Eastern an increased ability and incentive to unilaterally reduce capacity or limit growth in capacity and accordingly to increase airfares.¹

In fact, the Proposed Conduct will facilitate and underpin growth and expansion of the Applicants' services between Australia and China.

This is a significant public benefit in circumstances where the Australia-China market has matured, with passenger demand moderating from the peaks experienced during 2011-2013 and the significant additions of capacity introduced from 2010. Slowing passenger demand has led to more measured

¹ Commission's Draft Determination, paras 144, 184, 194.

capacity additions by all carriers recently. However, the newly signed bilateral agreement between Australia and China provides scope for renewed capacity growth, particularly by new entrants.

The Proposed Conduct enables the Applicants to sustainably grow capacity and remain relevant and effective competitors in the Australia-China market. In the absence of the Proposed Conduct, neither Applicant has any intention to introduce the Proposed Capacity in the short to medium term.

[REDACTED – COMMERCIAL IN CONFIDENCE]

The introduction of capacity is incentivised by risk sharing

Developing a profitable network involves considerations about how to best meet customer demand, deliver on strategic imperatives and, in the case of Qantas, utilise finite resources. New markets and opportunities are assessed through this lens. For all carriers, any increase in capacity (whether seasonal or year-round, incremental or new) generates unavoidable costs and risks that need to be considered by a carrier.

The Proposed Conduct makes a decision by either Applicant to add services between Australia and China more commercially viable. As set out in detail in the HoustonKemp Report (Attachment 3 to the Applicants' submission on 24 April 2015), the financial payment terms of the Joint Coordination Agreement (JCA) will enable the risks of capacity growth to be shared by the carriers. This is primarily achieved through a mechanism that requires the parties to share all revenues generated on a given route over and above that generated in a baseline year.

HoustonKemp found that the JCA will:

- enhance the ability and incentive of both Qantas and China Eastern to meet any increase in demand through better utilisation of existing capacity; and
- reduce the risk to either party of expanding capacity and so, relative to the status quo, will enhance the incentive for investment in new capacity, thereby bringing forward the point in time at which such increased capacity is likely to be deployed.

In addition to risk sharing under the terms of the JCA, the Proposed Conduct will also incentivise capacity expansion by giving each Applicant the ability to offer customers shorter journey times, improved connectivity and increased frequent flyer benefits, while also leveraging the other carriers' existing sales and distribution capability. These factors all support capacity deployment given that they stimulate demand.

The Proposed Conduct makes capacity deployment more sustainable. For example, **[REDACTED – COMMERCIAL IN CONFIDENCE]**

New capacity is made more sustainable when it can be linked to 'behind' and 'beyond' networks. The Proposed Conduct will allow the Applicants to access larger traffic pools. **[REDACTED – COMMERCIAL IN CONFIDENCE]**

Increased likelihood of further capacity increases

In addition to the Proposed Capacity to be implemented by China Eastern, the Proposed Conduct will increase the potential for Qantas to deploy new capacity between Australia and China.

Qantas cannot fly profitably to every destination in China. However, through maximising Qantas' brand presence throughout China and providing a viable beyond network proposition for customers, the Proposed Conduct provides a more sustainable platform from which Qantas can assess future growth opportunities while maintaining own metal presence in other key markets throughout Asia (i.e. Japan, Hong Kong, Singapore, Bangkok, Philippines and Indonesia).

It is in the interests of both Applicants for Qantas to be incentivised to grow capacity to China and to maintain relevance in the Australia-China market.

If the Proposed Conduct is not authorised, this will not be possible and Qantas would be increasingly marginalised in the Australia-China market.

27 July 2015