



Australian
Competition &
Consumer
Commission

Determination

Applications for authorisation

lodged by

Qantas Airways Limited and China Eastern Airlines
Corporation Limited

in respect of

a Joint Coordination Agreement

Date: 21 August 2015

Authorisation numbers: A91470 & A91471

Commissioners:

Sims
Rickard
Schaper
Cifuentes
Court
Featherston
Walker

Summary

The ACCC has decided to grant conditional authorisation to Qantas Airways Limited and China Eastern Airlines Corporation Limited to coordinate their operations between Australia and China pursuant to a Joint Coordination Agreement.

Authorisation is subject to conditions which require the airlines to maintain at least an aggregate base level of capacity across routes between Shanghai and Australia and also maintain at least their current level of capacity on the Sydney – Shanghai route. The Applicants are also required to grow capacity in aggregate across routes between Shanghai and Australia over the term of the authorisation by a compound annual growth rate of 4%.

The conditions of authorisation also require the Applicants to provide specific data to the ACCC at the end of each scheduling season, including data about capacity added, passengers flown and average fares on each route between Australia and China on which they operate services. The ACCC will use this data to assess the extent to which the public benefit claims made by the Applicants, particularly in relation to the Joint Coordination Agreement facilitating new frequencies and destinations and developing China Eastern's Shanghai hub as a gateway to greater China for Australian passengers, are realised.

In this respect, the Applicants have proposed to add significant additional capacity over the first two years of the authorisation. However, the ACCC expects there would be significant additional growth in capacity over the remaining three years of the authorisation, in order for the public benefits claimed by the Applicants to be realised. In the absence of such capacity growth, it may be difficult for the ACCC to accept that the proposed alliance facilitates the addition of new frequencies and destinations and the development of Shanghai as a gateway to greater China for Qantas and China Eastern in any application for re-authorisation.

The ACCC is concerned that as Qantas and China Eastern are each other's closest competitors on the one route on which the Applicants overlap with direct flights, Sydney – Shanghai, the competitive constraint they impose on each other is likely to be lost under the proposed alliance. This would provide Qantas and China Eastern with the ability and incentive to increase prices on this route. The data the Applicants are required to provide will allow the ACCC to monitor this. If Qantas and/or China Eastern did raise their prices on the Sydney – Shanghai route, relative to other routes between Australia and China, this would be likely to generate a significant public detriment which would be relevant to the ACCC's assessment of the public benefits and detriments likely to result from the alliance in considering any application for re-authorisation.

The ACCC grants authorisation until 31 October 2020.

On 18 November 2014, Qantas and China Eastern (the Applicants) applied for authorisation to coordinate their operations between Australia and China pursuant to a Joint Coordination Agreement (the Coordination Agreement).

The Applicants plan to coordinate their operations in the following areas:

- schedules, frequencies and connection times

- expanding connecting services and destinations
- developing new fare products and promotions
- airport facilities, by expanding reciprocal airport lounge access, improving facilities within lounges and streamlining check-in facilities for passengers, and co-locating their operations in Terminal 1 at Shanghai Pudong airport
- 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 with the other Applicant and
- reciprocal inventory access and provision of information to agents to facilitate more bookings on both Applicants' services, including group bookings.

Qantas and China Eastern are seeking authorisation for five years.

The ACCC considers that the networks of Qantas and China Eastern are largely complementary in terms of geographic coverage and destinations served. Both have extensive domestic networks in their home country and extensive international networks operating out of their home country hubs. However, in the draft determination the ACCC expressed concerns about the impact on competition of the Proposed Conduct on the one route between Australia and China on which Qantas operates direct flights, Sydney – Shanghai. The ACCC concluded that the lessening of competition on this route that would arise as a result of the Proposed Conduct was likely to outweigh any of the public benefits likely to arise from the Proposed Conduct. The ACCC therefore proposed to deny authorisation.

Since the draft determination was released the Applicants have provided a significant amount of new information, particularly in support of their public benefit claims.

Specifically, in the draft determination the ACCC noted that while the Proposed Conduct may assist in the facilitation of the adoption of more frequencies and destinations between Australia and China by the Applicants they had not provided any information or evidence in support of these claims. Therefore, the ACCC concluded that while this was a potential source of public benefit there was not sufficient evidence to conclude that it was likely to occur.

Following the release of the draft determination the Applicants advised that if authorisation is granted China Eastern will introduce a year round service on a new route, the details of which were provided to the ACCC on a confidential basis, and additional seasonal services between Shanghai and each of Sydney, Melbourne and Cairns. The Applicants submitted that the increased frequencies to Sydney and Melbourne may be extended to year round depending on demand. The Applicants also provided details of a significant expansion in the range of destinations that will be covered by their current codeshare agreement if their proposed alliance proceeds. The proposed expansion covers many more domestic routes in both Australia and China than is currently the case.

The Applicants submitted that this will provide significant public benefits for travellers between Australia and China by increasing the attractiveness of China Eastern's Shanghai hub as a gateway for connecting services between mainland China and Australia. In this respect the Applicants submitted that the Proposed Conduct is intended to establish a gateway to North East Asia for Qantas.

The Applicants also proposed a condition of authorisation aimed at addressing the ACCC's concerns about the likely impact on competition of the Proposed Conduct on the Sydney – Shanghai route.

The ACCC also received a significant number of submissions from interested parties in response to the draft determination. Most of these submissions supported the Proposed Conduct being authorised.

The ACCC has had regard to the additional information provided by the Applicants and interested parties in its assessment below.

Public benefit

The ACCC considers that there is a greater prospect of new frequencies, direct services and destinations in the future under the proposed alliance. In particular, the financial payment terms of the Joint Coordination Agreement lessens the commercial risk to China Eastern in undertaking capacity expansion making such capacity expansion more likely. Further, the Applicants will be able to combine load volumes and the expansion of the codeshare routes and coordination of their schedules to facilitate greater connectivity will also promote greater traffic on routes between Australia and Shanghai and thereby contribute to underpinning the viability of expanding capacity. The ACCC also accepts that, as submitted by the Applicants, adding additional capacity in peak periods can be used to test demand and ascertain the viability of additional year round services.

However, the ACCC also notes that China Eastern has been steadily expanding capacity on routes between Shanghai and Australia in recent years without the Proposed Conduct. The proposed growth in frequencies that it has advised the ACCC about, when considered over the five year term of the authorisation sought, is broadly consistent with its historical growth rates. However, the ACCC also notes that all the expansion in seats flown which China Eastern proposes to undertake will occur in the first two years of the alliance, and the level of expansion proposed, over this short a period, is in excess of their historical growth rates.

The ACCC accepts that the Applicants may not wish to commit to further capacity additions beyond the first two years of the term of authorisation sought until closer to the time that further capacity would be added, when they would have more certainty about market conditions and passenger demand.

However, notwithstanding this, having regard to trends in historical growth in capacity by the Applicants, the ACCC expects that successful implementation of the gateway strategy underpinning their public benefit arguments should result in significant additional growth in capacity above that which the Applicants currently propose. That is, while the proposed capacity expansions over the first two years of the alliance are significant, the ACCC would expect to see further significant growth in capacity over the remaining three years. If this were not the case, it may be difficult for the ACCC to accept that the alliance facilitates the addition of new frequencies and destinations and the development of Shanghai as a gateway to greater China for Qantas and China Eastern in any application for re-authorisation.

As noted, following the draft determination the Applicants also advised of a significant expansion in the range of destinations that will be covered by their current codeshare agreement if their proposed alliance proceeds. The ACCC considers that the expansion in destinations covered by the alliance is likely to result in a number of public benefits. Passengers will have access to a greater range of online connections (itineraries of two

or more flights where connections are made between flights of the same airline or its codeshare partners) removing the risk of forfeiting non-refundable funds if the first journey is delayed, increasing convenience in not having to collect and recheck baggage, saving time in through checking and reducing transit times.

Expanding the number of routes where journeys can be booked on a single ticket (rather than requiring tickets to be booked with both airlines) should also lead to lower prices for passengers utilising a connection in Australia or a connection in Shanghai that involves flights operated by both Qantas and China Eastern. If, absent coordination between the Applicants, these flights have to be booked separately, each airline will charge a price which includes a mark-up to cover their costs but does not take account of the impact on the other airlines profit (double marginalisation). By coordinating their pricing this 'double mark-up' is eliminated.

By enabling Qantas to co-locate at China Eastern's terminal in Shanghai the Proposed Conduct will also provide passengers on Qantas flights from Sydney to Shanghai with improved connectivity and convenience when transferring to a China Eastern flight for onward travel. However, passengers who value the convenience of not having to change terminals when transferring between flights are already able to fly with China Eastern directly, or in the case of some destinations, with other airlines that transit through hubs other than Shanghai. Therefore, the ACCC considers that while the improved connectivity and convenience resulting from terminal co-location is a public benefit it is likely to accrue only to customers who wish to transfer to a China Eastern flight in Shanghai for onward travel and who have a preference to fly with Qantas for the Sydney – Shanghai leg of their journey.

The Proposed Conduct is also likely to enable better scheduling of complementary services by the Applicants, thereby facilitating greater connectivity between their services than under the existing codeshare agreement.

The ACCC also accepts that the Proposed Conduct will facilitate the Applicants proposed gateway strategy by increasing the attractiveness of China Eastern's Shanghai hub for connecting services between Australia and mainland China. In particular, the increased connectivity and convenience and increased frequencies likely to result from the Proposed Conduct will make flights transiting through Shanghai a more attractive proposition for some passengers travelling to points in China not serviced by direct flights. However, the ACCC has not placed great weight on this as a separate public benefit resulting from the Proposed Conduct because regard has already been had to it in the ACCC consideration of the specific public benefit arguments about increased connectivity and expanded frequencies and destinations. Nor has the ACCC placed weight on the related argument that this will result in a public benefit by triggering a competitive response from rivals. The ACCC considers that rival airlines will continue to strongly compete for passengers transferring into greater China with or without the alliance in place.

Further, the ACCC would expect that to the extent that the Applicants expect that the Proposed Conduct will allow them to compete more effectively with other hubs, this would be reflected in an expectation of significant additional traffic on flights operated by them between Australia and China. As discussed above, the additional capacity the Applicants currently propose to add is broadly consistent with their historical capacity expansion and does not appear to accord with an expectation that the Applicants will capture a significantly greater proportion of existing passengers traveling into greater China than is currently the case or stimulate significant additional demand for services into greater China.

The ACCC has imposed conditions of authorisation requiring the Applicants to report each scheduling season about the number of passengers carried on each route between Australia and China. If, as the applicants submit, the Proposed Conduct facilitates the development of China Eastern's Shanghai hub as a gateway to greater China for Australian passengers the ACCC expects this reporting to reflect a significantly increase in the number of passengers flying beyond Shanghai with China Eastern. Were this not the case this would call into question the Applicants arguments about the Proposed Conduct facilitating this gateway strategy. This will be an important consideration in the ACCC's assessment of any application for re-authorisation.

The ACCC also considers that the Proposed Conduct is likely to result in public benefits through enhancing the attractiveness of the Applicants' loyalty programs, and cost savings resulting from terminal co-location in Shanghai, which allows for more efficient management of transiting passengers and streamlining of processes for handling freight being transported to Shanghai by Qantas and onwards by China Eastern.

The ACCC also recognises that the Proposed Conduct has the potential to result in some public benefit in the form of the promotion of tourism and trade between Australia and China. In particular, the expansion of the routes covered by the existing codeshare agreement will provide greater connectivity for China Eastern passengers on a greater range of Qantas domestic services. However, given the wide range of other factors which are likely to be more significant determinants of tourism and trade, the ACCC does not consider the impact of the Proposed Conduct on tourism and trade is likely to be significant.

Public detriment

The own metal operational overlap between the Applicants is limited to the one direct route between Sydney and Shanghai. The potential for the Proposed Conduct to generate significant competitive detriment is largely limited to this one route. The ACCC notes that this route accounts for around 23% of all travel between Australia and China (direct flights).

The ACCC considers that Qantas and China Eastern are the two major carriers on the Sydney – Shanghai route and that each is likely to be the most significant competitive constraint on the other on this route. Accordingly, the potential competitive detriment generated by the Proposed Conduct is likely to be significant.

Qantas and China Eastern had a combined share of capacity (seats flown) on the Sydney – Shanghai route of 84.5% over the 12-month period from April 2014 to March 2015 (direct flights). The only other airline offering direct flights on the route is Air China. However, unlike Qantas and China Eastern, Air China does not operate a daily service on this route and has been reducing capacity over the last five years while Qantas and China Eastern have been adding capacity. The ACCC does not consider that Air China will sufficiently constrain Qantas and China Eastern in the event they decide to reduce or limit growth in capacity to increase airfares if the Proposed Conduct is authorised.

The ACCC also considers indirect services provided by other airlines (for example, journeys that transit through Hong Kong, Singapore and Malaysia) are likely to be weaker competitive constraints on Qantas and China Eastern on this route than Qantas and China Eastern are on each other. While numerous airlines provide indirect flights between Sydney and Shanghai, data available to the ACCC suggests that indirect flights account for only around 12% to 15% of all passenger traffic between Sydney and Shanghai. This is despite the fact that airlines offering a one stop flight between Sydney

and Shanghai are priced comparably to, and on occasion significantly cheaper than, direct flights offered by the Applicants.

Demand for air services in China has grown rapidly over the last five years, both in terms of new frequencies and new routes, and can be expected to continue to grow in the short to medium term. However, the ACCC considers that timely entry or expansion on the Sydney – Shanghai route on a scale sufficient to provide a competitive constraint is unlikely. China Eastern and Air China are the only airlines flying international longhaul flights with hubs in Shanghai and the ACCC is not aware of any other airlines with plans to establish a base in Shanghai and offer longhaul services.

As discussed above, the Proposed Conduct is likely to improve the ability for Qantas and China Eastern to attract passengers traveling into greater China through China Eastern's Shanghai hub. In this respect the ACCC notes that decisions by the Applicants about the capacity to allocate to routes between Australia and Shanghai will have regard to servicing both point to point and transferring passengers. With respect to passengers travelling into greater China, competition from other hubs means that limiting capacity to increase airfares (for these passengers) is unlikely to be a profitable strategy. Therefore any consideration of limiting capacity to increase airfares for point to point passengers would involve a trade off with the likely loss of transferring passengers to airlines operating through other hubs. This is likely to mitigate, to some extent, incentives for the Applicants to limit capacity as a means of increasing airfares for Sydney – Shanghai point to point passengers.

However, even if the Applicants' decisions about allocating capacity on routes between Australia and China are ultimately primarily driven by endeavouring to capture more passengers traveling to destinations in greater China, the limited competition from other airlines on the Sydney – Shanghai route means that the Proposed Conduct will provide them with the ability and incentive to increase prices for passengers traveling directly between these two cities. That is, while fares will be set by the Applicants for travellers whose final destination is a point in greater China beyond Shanghai having regard to the numerous other hubs through which the passenger could transfer to reach their destination, as discussed above, the competitive constraint on the Applicants in setting fares on the Sydney – Shanghai point to point route is far more limited.

The conditions of authorisation the ACCC has imposed require the Applicants to report to the ACCC on route specific costs, revenues and average fares each scheduling season. If the Applicants do charge higher prices for passengers travelling on the Sydney – Shanghai point to point route than they do for passengers transferring through Shanghai to other destinations where the Applicants face greater competition from other hubs, this will be apparent from this reporting. If Qantas and/or China Eastern did raise their prices on the Sydney – Shanghai route, relative to other routes between Australia and China, this would be likely to generate a significant public detriment which would be relevant to the ACCC's assessment of the public benefits and detriments likely to result from the alliance in considering any application for re-authorisation.

The ACCC has also imposed conditions of authorisation requiring the Applicants to increase the number of seats they fly on routes between Shanghai and Australia at a rate that accords with the additional capacity they currently submit that they will add. This will ensure that the Proposed Conduct does not result in a reduction in the frequency of services provided below that which could be expected if the alliance was not in place and Qantas and China Eastern continued to compete strongly with each other for passengers.

In summary, the ACCC considers that the Proposed Conduct will improve the Applicants ability to compete for passengers travelling to destinations between China and Australia not serviced by direct flights. However, on the Sydney – Shanghai route, which currently accounts for 23% of all direct passenger traffic between Australia and China, Qantas and China Eastern are the major carriers and each other's closest competitors. The competitive constraint they impose on each other on this route, particularly in relation to setting fares, is likely to be lost if the Proposed Conduct proceeds.

Balance of public benefit and detriment

The ACCC considers that the Proposed Conduct is likely to result in a range of public benefits. As discussed above, the Applicants have further substantiated a number of their important public benefit arguments since the draft determination was released. In particular, the Applicants have provided more evidence in relation to increased connectivity and convenience for passengers and expansion of frequencies and destinations flown.

The ACCC remains of the view expressed in the draft determination that on the Sydney – Shanghai route the extent of the reduction in competition, and associated public detriment, is likely to be significant.

In light of the ACCC's conclusion that the magnitude of the public benefits likely to result from the Proposed Conduct is greater than accepted in the draft determination the ACCC has considered whether conditions of authorisation could be developed that would mitigate the likely public detriment and/or ensure the realisation of the public benefits submitted by the Applicants.

On balance, after weighing the public benefits and detriments discussed above, the ACCC considers that subject to the conditions outlined the Proposed Conduct is likely to result in public benefits that would outweigh the detriment to the public constituted by any lessening of competition that would result or would be likely to result from the proposed conduct.

However, as noted above, having regard to:

- the Applicants argument that the alliance will facilitate significant expansion of frequencies and destinations and improve their ability to compete, through China Eastern's Shanghai hub, with other airlines for passengers travelling into greater China
- the capacity additions the Applicants are currently prepared to commit to, when considered over the five year term of the authorisation sought, reflecting expansion that is broadly consistent with their historical growth on relevant routes, and
- the Applicants' argument that the capacity additions they are prepared to commit to can be used to test the market and that the services will be further extended to year round if demand is sufficiently stimulated

the ACCC would expect to see evidence of these public benefits being realised in the form of significant capacity expansion and significant increases in passengers traveling through China Eastern's Shanghai hub into greater China over the term of the authorisation. If this were not the case it may be difficult for the ACCC to accept these public benefit arguments in considering any application for re-authorisation.

Conditions

The *Competition and Consumer Act 2010* (C'th) allows the ACCC to grant authorisation subject to conditions.

The ACCC is imposing conditions requiring the Applicants to:

- maintain at least their current level of capacity, in aggregate, across all routes between Australia and Shanghai during each scheduling season over the term of the authorisation (five years).
- increase their capacity on routes between Shanghai and Australia over the term of the authorisation by a compound annual growth rate (**CAGR**) of 4%. To achieve the CAGR the Applicants will have to increase their capacity across routes between Australia and Shanghai by around 21.67% over the next five years.
- maintain at least their current level of capacity on the Sydney – Shanghai route during each scheduling season over the term of the authorisation.

The Applicants are not, in the first instance, required to add capacity specifically on the Sydney – Shanghai route. However, the ACCC is able to review, and require that a CAGR be applied specifically to the Sydney – Shanghai route, over the term of the authorisation. The ACCC is also able to review the 4% CAGR applied in aggregate across all routes between Shanghai and Australia at any time.

The ACCC has set the CAGR to apply in aggregate across all routes between Shanghai and Australia at 4% having regard to the Applicants historical growth on relevant routes and their planned capacity expansions over the term of the authorisation. The ACCC has also had regard to the five year term of the authorisation sought and commercial uncertainty about market conditions over the term. However, all else being equal, in considering any application for re-authorisation, the ACCC would be unlikely to accept the public benefit argument that the Proposed Conduct facilitates the addition of new frequencies and destinations unless evidence, in the form of growth in capacity over the term of the initial authorisation of a magnitude significantly greater than required by the conditions, was provided.

The Applicants are also required to report each scheduling season on seats and passengers flown (including separately reporting point to point and connecting passengers), route specific costs and revenues and average fares.

The revenue, cost and load factor information (seats flown versus passengers flown) will assist in gauging during the term of the authorisation whether the CAGR, and particularly whether the Sydney – Shanghai CAGR, initially set at zero, is set too high or too low. It will also provide an indication of whether fares on the Sydney – Shanghai route are rising relative to costs, both in absolute terms and compared to other routes flown by the Applicants. This, along with other information required to be reported will assist in assessing whether capacity is keeping pace with growth in demand. This information will also evidence any instance of Qantas and/or China Eastern raising fares on the Sydney – Shanghai point to point route, relative to other routes between Australia and China and the extent to which the Proposed Conduct facilitates the development of China Eastern's Shanghai hub as a gateway to greater China for Australian passengers.

Further, the requirement to report this information, coupled with the ability for the ACCC to review the Shanghai – Australia CAGR and impose a Sydney – Shanghai specific CAGR at any time is likely in itself to act as a constraint on the Applicants in setting prices and allocating capacity on the Sydney – Shanghai route.

Accordingly, the ACCC grants conditional authorisation until 31 October 2020.

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Abbreviations

ACCC	Australian Competition and Consumer Commission
Applicants	Qantas Airways Limited (and its related bodies corporate) and China Eastern.
Australian Major Gateways	Sydney, Melbourne (including Avalon), Brisbane and Perth
BITRE	Bureau of Infrastructure, Transport and Regional Economics
CAAC	Civil Aviation Administration of China
CAGR	Compound annual growth rate
CCA	<i>Competition and Consumer Act 2010</i> (Cth)
China Eastern	China Eastern Airways Corporation Limited
Chinese Major Gateways	Beijing, Shanghai and Guangzhou
codeshare	arrangements involving the assignment of one airline's designator code to a flight operated by another airline
Coordination Agreement	Joint Coordination Agreement entered into by Qantas and China Eastern on 17 November 2014
DIRD	Department of Infrastructure and Regional Development
FTA	China-Australia Fair Trade Agreement
IASC	International Air Services Commission, established by the <i>International Air Services Commission Act 1992</i> (Cth)
interlining	interlining involves the carriage of passengers and/or freight between two points using the services of more than one airline under an arrangement which typically involves baggage check through and the honouring of tickets between airlines
Proposed Conduct	the conduct for which authorisation is sought as set out at paragraphs 10 to 16.
Qantas	Qantas Airways Limited
Tribunal	Australian Competition Tribunal

The applications for authorisation

1. On 18 November 2014, Qantas Airways Limited (**Qantas**) and China Eastern Airlines Corporation Limited (**China Eastern**) (together, the **Applicants**) lodged applications for authorisation¹ (A91470 & A91471) with the ACCC. The Applicants are seeking authorisation for five years to coordinate their operations between Australia and China pursuant to a Joint Coordination Agreement (**Coordination Agreement**).

The Applicants

Qantas Airways Limited

2. Qantas was incorporated in Australia in 1920 and is Australia's largest domestic and international airline.
3. The Qantas Group operates more than 6400 domestic and 920 international flights each week using two complementary airlines: Qantas – a full service airline offering domestic and international services; and Jetstar Airways – a low cost carrier offering domestic and international services, predominantly focussed on servicing price sensitive consumers.
4. The Qantas Group is currently a party to the following airline alliances:
 - an alliance with Emirates, which was authorised by the ACCC on 27 March 2013
 - an alliance with American Airlines pursuant to a Joint Business Agreement which was authorised by the ACCC on 29 September 2011² and
 - the oneworld marketing alliance including ticketing passengers with Cathay Pacific and Dragonair to destinations in China.
5. Qantas also has international codeshare arrangements with Alaskan Airlines, WestJet, Finnair, British Airways, Jet Airways, Bangkok Airways, China Airlines, China Southern, China Eastern, Vietnam Airlines, Sri Lanka Airlines, JAL, Asiana, Jetstar Asia, LAN Chile, Fiji Airways, Air Vanuatu, Air Niugini, Alliance Airlines, Aircalin, Air North, and Air Tahiti Nui.

¹ Authorisation is a transparent process where the ACCC may grant protection from legal action for conduct that might otherwise breach the Competition and Consumer Act 2010 (the CCA). Applicants seek authorisation where they wish to engage in conduct which is at risk of breaching the CCA but nonetheless consider there is an offsetting public benefit from the conduct. Detailed information about the authorisation process is available in the ACCC's Authorisation Guidelines at www.accc.gov.au/publications/authorisation-guidelines-2013

² On 10 June 2015 the Applicants lodged an application for revocation and substitution of this authorisation. The application was lodged because the arrangements have been redesigned to take account of recent developments, including the planned commencement of services by American Airlines between Los Angeles and Sydney from December 2015. On 9 July 2015, the ACCC granted interim authorisation to the redesigned arrangements.

6. Qantas also operates a number of other related services in areas including engineering, ground handling, flight training, freight and aircraft catering and cleaning.

China Eastern Airlines

7. China Eastern is a full-service carrier and one of China's three largest airlines. Its main hubs are at Shanghai's Pudong International and Hongqiao International airports, with secondary hubs at Kunming Changshui International Airport and Xi'an Xianyang International Airport.
8. 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, founded in 1996, is a state-owned enterprise incorporated in China and the parent company of China Eastern, with a shareholding of 64.36%. China Eastern was listed on the Hong Kong, New York and Shanghai stock exchanges in 1997. China Eastern's wholly owned subsidiary China Cargo Airlines provides freight services.
9. China Eastern is one of the largest carriers in the world by passengers flown. In 2013, it carried almost 80 million passengers utilising a fleet of 451 passenger aircraft. China Eastern also operates 14 freight and 13 business aircraft. China Eastern has an established network throughout China and extending to Japan, Korea, South East Asia, Europe, North America and Oceania and is a member of the SkyTeam Alliance.

The proposed conduct

10. The Applicants are seeking authorisation for themselves and their related bodies corporate to give effect to a Coordination Agreement that provides for coordination of their operations between Australia and China, including in relation to pricing and capacity (seats flown). The Coordination Agreement contemplates that the scope of coordination will evolve and may be altered from time to time. For example, the Applicants state that they may add or remove routes and flights which are the subject of particular types of coordination.
11. The Applicants state that, pursuant to the Coordination Agreement, they plan to coordinate their activities and operations, including in relation to:
 - improving schedules, frequencies and connection times
 - enabling the expansion of destinations served by their operations
 - expanding connecting services at primary gateways leading to more one-stop online points of service
 - developing new fare products and promotions
 - improving coordination of use of airport facilities by expanding reciprocal airport lounge access, improving facilities within lounges and streamlining check-in facilities for passengers
 - co-locating their operations in Terminal 1 at Shanghai Pudong airport

- increasing opportunities for each other's frequent flyers to earn and/or redeem frequent flyer points and take advantage of other membership benefits when travelling with the other Applicant
 - increasing the international competitiveness of both Applicants
 - easing planning itineraries through the provision of better information to agents, and
 - improving reciprocal inventory access to facilitate more bookings on both Applicants' services, including group bookings.
12. The Applicants further state that they 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.
 13. The Applicants also provided a non-exhaustive list of goods and services which they may seek to jointly procure which included inflight catering, lounges, logistics, corporate services, inflight goods and services, crew accommodation, labour hire, airport charges, fuel, ground handling, aircraft maintenance, inflight entertainment and aircraft components.
 14. 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 carrier's 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 (i.e. each carrier has access to every seat on the other carrier's flights which are operated between Australia and China).
 15. However, the Applicants do not intend to pursue a model of 'metal neutrality' under which each party would be indifferent as to whether it sold tickets for a flight operated using its own aircraft or a flight operated using its partner's aircraft.
 16. The Applicants are seeking authorisation for five years.

The Applicants' rationale for entering into the Coordination Agreement

17. Qantas submits that it needs a Chinese partner to most effectively provide a seamless customer proposition throughout China. By being able to expand its product offering by selling on China Eastern's services and coordinating what it considers to be complementary customer propositions, Qantas submits it can improve its profitability without the need for significant additional capital outlay. Qantas submits that it will be able to utilise China Eastern's sales and distribution network within China, particularly through China Eastern's hub in Shanghai, to help facilitate increased passenger flow on its international and domestic services, and will be able to offer a product proposition that is better aligned with the predominately leisure-oriented and student passenger base originating from China.
18. Qantas further submits that alliances generally need to be based the ability for each carrier to deliver traffic to the other carriers gateway port(s). Qantas states that a gateway strategy depends on their being a meeting of networks or at least

some operational overlap to deliver these traffic flows. Qantas argues that it would not be feasible for it to achieve its gateway strategy with another Chinese carrier in a port to which Qantas does not already fly or has no intention of operating, particularly in respect of a market like China which has its strongest growth activity oriented around secondary interior markets.

19. Qantas submits that, despite the Australia-China passenger air services market growing, its share has been declining and it is not earning a return on capital on its own operations, primarily due to its high cost base. Qantas contends that, without the Coordination Agreement, it is likely to become increasingly marginalised in respect of the Australia-China market.
20. China Eastern submits that it needs an Australian partner to provide improved sales and distribution capability. It submits that the Coordination Agreement will enable China Eastern to build on Qantas' domestic business and frequent flyer proposition by accessing high-yielding Australian domestic corporate and government travellers. China Eastern submits that the Coordination Agreement will give its worldwide sales force better access to sell to and from Australia. It further submits that it will benefit from accessing Qantas' extensive product knowledge and operational insights.
21. China Eastern submits that, over the longer term, the Coordination Agreement will result in operational efficiencies and cost savings which will allow it to enhance and expedite its long term capacity growth in Australia more than would otherwise be the case.

Background

Relevant airline capacity entitlements between Australia and China

22. The international airline industry is highly regulated. The *1944 Convention on International Civil Aviation* established the principle that each country has exclusive sovereignty over its airspace. This principle continues to guide the regulatory framework today.
23. International air transport services between two countries must be specifically authorised pursuant to bilateral air services arrangements.
24. Australia's 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* signed 23 March 2004, and two Memoranda of Understanding (MoU) between the aeronautical authorities of Australia and China – the MoU signed in Beijing on 9 July 2003 and another MoU signed in Guangzhou on 2 March 2011.³
25. These arrangements 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. These arrangements were renegotiated in January 2015 with new arrangements announced by the Minister for Infrastructure and Regional Development and the Minister for Trade and Investment on 23 January 2015.⁴ The new rights were available to airlines from 21 January 2015.
26. Under the revised air services arrangements, from 21 January 2015 the following capacity entitlements are available:
 - when operating services between the Chinese Major Gateways (Beijing, Shanghai, Guangzhou) and the Australian Major Gateways, airlines of both sides may operate the following:
 - i. with immediate effect, 26,500 seats each way each week
 - ii. from October 2015, 30,500 seats each way each week and
 - iii. from October 2016, 33,500 seats each way each week.
 - when operating services between all cities in China other than the Chinese Major Gateways and the Australian Major Gateways, airlines of both sides may operate the following:

³ Department of Infrastructure and Regional Development, 18 December 2014 submission, p 2.

⁴ Warren Truss (Minister for Infrastructure and Regional Development) and Andrew Robb (Minister for Trade and Investment), *New air deal with China: 2015 off to a flying start for Australian tourism*, media release, 23 January 2015
http://www.minister.infrastructure.gov.au/wt/releases/2015/January/wt013_2015.aspx as at 4 March 2015.

- i. with immediate effect, 26,500 seats each way each week
 - ii. from October 2015, 30,500 seats each way each week and
 - iii. from October 2016, 33,500 seats each way each week.
27. If airlines link a Chinese Major Gateway and a Chinese city other than a Major Gateway as part of a multi-stop international service, the city of first arrival/last departure in China will determine whether the service counts against Major Gateway or non-Major Gateway capacity.
28. Airlines of both nations have unrestricted access to/from all points in Australia other than the Australian Major Gateways and airlines of each side linking an Australian Major Gateway and another city in Australia as part of a multi-stop international service may operate an extra 2,500 seats each way each week.
29. In Australia capacity entitlements are allocated by the International Air Services Commission (**IASC**). Qantas currently has 4,471⁵ seats allocated to it and is currently the only Australian airline allocated capacity on routes to China.
30. In China capacity entitlements are allocated by the CAAC. There is no publically available information in relation to the allocation of capacity to Chinese carriers by the CAAC. China Eastern did provide details of its capacity entitlements on the Shanghai – Sydney and Shanghai – Melbourne routes.
31. Prior to the air services arrangements being renegotiated in January 2015 the designated capacity for airlines in each country on routes to and from Sydney, Melbourne, Brisbane and Perth was 22,500 seats each way. All 22,500 seats available to Chinese carriers prior to 21 January 2015 had been allocated.
32. In a submission in response to the draft determination the Department of Infrastructure and Regional Development (**DIRD**) noted that the Australian Government's policy is to prioritise bilateral air service arrangements to ensure there is sufficient aviation capacity to meet future demand. The DIRD stated that should Chinese carriers approach the capacity limits under the newly negotiated arrangement the Government would review the air services arrangement to ensure consistency with this policy.

The Applicants' operations between China and Australia

Relevant routes operated by the Applicants

33. Qantas and its subsidiaries have few direct or indirect routes from Australia to mainland China. Instead, it largely services Chinese mainland destinations via flights to various South East Asian hub airports which then connect with oneworld, interline partners' or codeshare services into China.
34. Current direct services between China and Australia operated by the Applicants are:
 - Qantas operates a daily service between Sydney and Shanghai (China Eastern codeshares on this service)

⁵ International Air Services Commission, 16 December 2014 submission, p 2.

- China Eastern operates a daily service between each of Sydney and Melbourne and Shanghai, with increased frequencies in peak periods (Qantas codeshares on the Melbourne-Shanghai service)
 - China Eastern operates a three times per week service between Sydney and Beijing (via Nanjing) (Qantas codeshares on this service), and
 - China Eastern operates a direct seasonal service between Cairns and Shanghai.
35. Current indirect services between China and Australia offered by the Applicants include:
- Qantas operates services from Melbourne/Brisbane/Sydney to Singapore (China Eastern codeshares on these services) and
 - China Eastern operates connecting services from Singapore to Shanghai (Qantas codeshares on these services).
36. Qantas' Jetstar subsidiaries also currently operate a number of indirect services between China and Australia. Jetstar Airways operates services from Melbourne to Singapore and Jetstar Asia (49% owned by Qantas) operates services from Perth and Darwin to Singapore. Jetstar Asia then operates services between Singapore and Haikou, Shantou and Hangzhou in China.⁶
37. On 5 May 2015 Jetstar announced that it will operate a twice weekly direct service between the Gold Coast and Wuhan, commencing on 29 September 2015.
38. Finally, Qantas operates various connecting services domestically in Australia and on trans-Tasman routes on which China Eastern codeshares and Qantas codeshares on ten of China Eastern's domestic Chinese services.

Existing Codeshare Agreement between China Eastern and Qantas

39. Qantas and China Eastern entered into a codeshare agreement in July 2008 (the Codeshare Agreement). The Codeshare Agreement, as subsequently amended

⁶ Full details of Jetstar subsidiaries, in addition to Jetstar Airways, are:

- Jetstar Asia in 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), which is incorporated in Singapore and operates flights from Singapore to various destinations in Asia.
- Jetstar Pacific in which the Qantas Group has a 30% shareholding. Jetstar Pacific is incorporated in Vietnam and operates flights within Vietnam and to Bali and Bangkok. It may, subject to regulatory approvals, operate international services from Vietnam to other destinations in Asia in the future.
- Jetstar Japan in which the Qantas Group has a 33% voting shareholding. Jetstar Japan is incorporated in Japan and began operating flights within Japan from 3 July 2012.
- Jetstar Hong Kong in which the Qantas Group and China Eastern each have a 33½% shareholding. Jetstar Hong Kong proposes to operate flights from Hong Kong to China and various destinations in Asia, subject to regulatory approvals.

The Proposed Conduct does not include coordination between Qantas or Jetstar and China Eastern in respect of Jetstar Hong Kong.

from time to time, allows Qantas to codeshare on a freesale basis on China Eastern's services between Sydney and Beijing (via Nanjing) and between Singapore and Shanghai, as well as between Shanghai and various destinations in China.

40. In turn, China Eastern codeshares on a freesale basis on Qantas' services between Singapore and Sydney/Melbourne/Brisbane and various trans-Tasman and domestic services within Australia
41. Qantas codeshares on a hard block basis (whereby Qantas has a block of seats on a China Eastern flight to sell) on China Eastern's Melbourne – Shanghai service. China Eastern codeshares on a hard block basis on Qantas' Sydney – Shanghai service.

Other Qantas codeshare arrangements involving China

42. Qantas also operates services from Melbourne, Sydney and Brisbane to a variety of South-East Asian destinations including Singapore and Hong Kong, which ultimately allows Qantas to market indirect connections to major mainland Chinese cities through its oneworld partners Cathay Pacific and Dragonair (interline) and codeshare partner China Southern.⁷
43. In particular, Qantas provides services to mainland China via Hong Kong through an existing relationship with Cathay Pacific. Qantas provides services to Hong Kong where passengers can join services operated by Cathay Pacific (or its subsidiary Dragonair) from Hong Kong into mainland China. Qantas states that it does not consider its Shanghai and Hong Kong gateways to be mutually exclusive and intends to retain its relationship with Cathay Pacific. Qantas states that in the context of the growing Australia-China market, it needs to be able to service mainland China using both the Hong Kong and Shanghai hubs.
44. Qantas also has a codeshare agreement with China Southern entered into in December 2013. Under the codeshare agreement Qantas codeshares on China Southern operated flights between Sydney, Melbourne, Brisbane, Perth and Guangzhou and between Guangzhou and Xiamen, Kunming, Fuzhou and Urumqi. China Southern codeshares on Qantas flights on 10 different routes within Australia and to New Zealand. Further details of China Southern's operations are provided below. Qantas states that it will retain its codeshare agreement with China Southern if the Proposed Conduct is authorised.

Other airlines operating between Australia and China

45. Other than Qantas and China Eastern, the main carriers servicing Australia-China, operating direct and/or indirect routes, include:⁸
 - China Southern – China Southern operates twice daily services between Guangzhou and Sydney, up to two daily services from Melbourne, up to

⁷ Qantas, *Connecting Australia to the world* <http://www.qantas.com.au/infodetail/about/investors/connecting-australia-to-the-world.pdf> as at 4 March 2015.

⁸ The information in this section is taken from Applicants submission in support of their Application for authorisation, 18 November 2014, subsequent submissions by the Applicants and public announcement of changes, and proposed changes, to routes and frequencies flown by airlines since the application was lodged.

daily services from Brisbane and four services per week from Perth. China Southern plans to move from twice daily to three times daily services between Guangzhou and Sydney from 10 December 2015 until 26 March 2016 and from 14 services a week to 18 services a week between Guangzhou and Melbourne from 5 December 2015 until 29 February 2016.

Xiamen Air, which is 51% owned by China Southern, has announced that it proposes to commence three time weekly services between Fuzhou and Sydney on 29 November 2015 and twice weekly services between Xiamen and Sydney commencing 5 December 2015.

China Southern also operates multiple services from Guangzhou to Shanghai (around ten per day). China Southern is the largest Chinese airline by capacity, fleet and passengers flown.

China Southern's base and primary hub is Guangzhou Baiyun Airport, with additional hubs in Beijing, Chongqing and Urumqi. China Southern has an extensive domestic network.

- Air China – Air China operates services to Beijing from Sydney up to seven times a week with an additional four flights per week to be added on a seasonal basis commencing in November 2015. It operates services between Beijing and Melbourne four times a week, scheduled to increase to a daily service from October 2015. It also operates services to Sydney from Shanghai three times a week and Melbourne five times a week.

Its base and most important hub is Beijing Capital International Airport with Shanghai Pudong International Airport being its secondary hub. Air China also has an extensive domestic network.

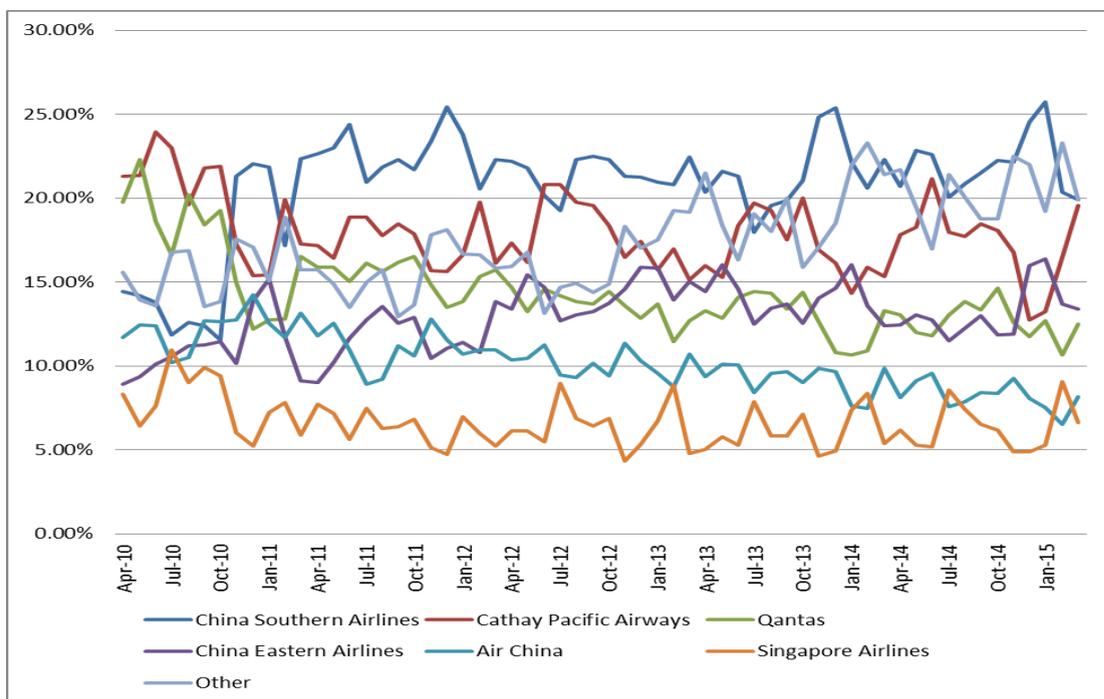
- Cathay Pacific – Cathay Pacific operates services to Hong Kong, with connections to mainland China, from Sydney, Melbourne, Brisbane, Adelaide, Cairns and Perth. As at November 2014 it operated 78 return frequencies weekly between Australia and Hong Kong, with Cathay/Dragonair having 433 return frequencies weekly from Hong Kong to mainland China, and Cathay Pacific operating 17 flights a day between Hong Kong and Shanghai.
- Sichuan Airlines – Sichuan Airlines operates services three times a week from Melbourne to Chengdu and two times a week from Sydney to Chongqing. It is based in Chengdu and serves more than 80 cities in China.
- Singapore Airlines – Singapore Airlines operates up to five daily services to Singapore from Melbourne, Sydney and Perth with onward connections to destinations in China (Guangzhou, Beijing and Shanghai). Singapore Airlines operates five daily services between Singapore and Shanghai. As at November 2014 it operated 113 return frequencies weekly in total to Singapore from Australia, with 56 return frequencies weekly from Singapore to China. Singapore Airlines' subsidiary Tiger Airways operates services from Perth to Singapore and on to regional destinations in South East Asia, including China.

- Malaysia Airlines – 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. From Australia, as at November 2014 it operated 72 return frequencies weekly to Kuala Lumpur, with 40 return frequencies weekly from Kuala Lumpur to China.

Air passenger travel between Australia and China

46. Unless otherwise noted, the information in this section about seats and passengers flown is based on data provided by the Bureau of Infrastructure, Transport and Regional Economics.
47. There were around 1,050,000 seats and around 860,000 passengers flown (each way) on direct flights between Australia and China in the year ended March 2015. This compares to around 645,000 seats and 505,000 passengers in the year ended March 2011.
48. Inclusive of indirect flights, for the year ending March 2015 Qantas and China Eastern had a combined share of passengers flown between Australia and China of around 25.8% (12.6% for Qantas and 13.2% for China Eastern). This compares to other major airlines China Southern – 21.8%, Cathay Pacific – 17.2%, Air China – 8.1% and Singapore Airlines – 6.5%.

Graph 1: Share of total passengers Australia – China⁹



49. Around 84% of passenger arrivals in Australia from China on direct flights come from Shanghai and Guangzhou. Over the five years ending March 2015 the share

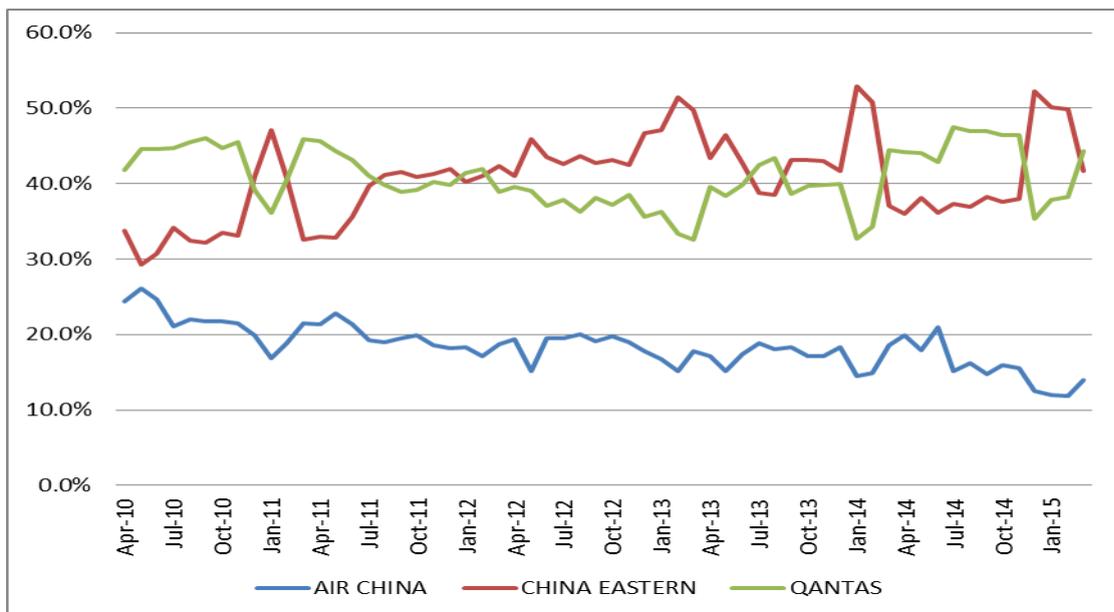
⁹ ACCC calculations from information provided by the Bureau of Infrastructure, Transport and Regional Economics based on passenger card data collected and compiled by the Department of Immigration and Border Protection.

of travellers departing from Shanghai has substantially decreased (from around 56% to around 40%) while the share of travellers departing from Guangzhou has significantly increased (from around 33% to around 44%). This reflects a significant increase in passengers flying with China Southern from its Guangzhou hub. However, most of this change in shares of arrivals to Australia occurred in 2010 and 2011. From 2012 onwards both departure points' share of Australian arrivals have been more stable compared to the preceding two years. Further, this change reflects growth in passenger traffic from Guangzhou. As discussed below, passenger traffic from Shanghai has also grown over the five years to March 2015 but not at the same rate as traffic from Guangzhou.

Air passenger travel between Sydney and Shanghai

50. In terms of their own metal operations between Australia and China, the Applicants only overlap on the Sydney – Shanghai route.
51. The only other carrier operating direct services on this route is Air China which operates services between Sydney and Shanghai three times a week. No other Chinese airline operates longhaul international flights (to any destinations) out of Shanghai's Pudong or Hongqiao airports.
52. Total seats flown on the route in in the year ended March 2015 were around 246,000 (each way, direct flights).¹⁰ This represents around 23% of all seats flown between Australia and China on direct flights.
53. For the year ending March 2015, Qantas and China Eastern had a combined share of capacity on the route of 84.5% (direct flights). This compares with a combined share of capacity of 78.5% in the year ending March 2011. Over the same period Air China's share of capacity has fallen from 21.5% to 15.5%.

Graph 2: Share of total capacity Sydney – Shanghai (direct only)¹¹

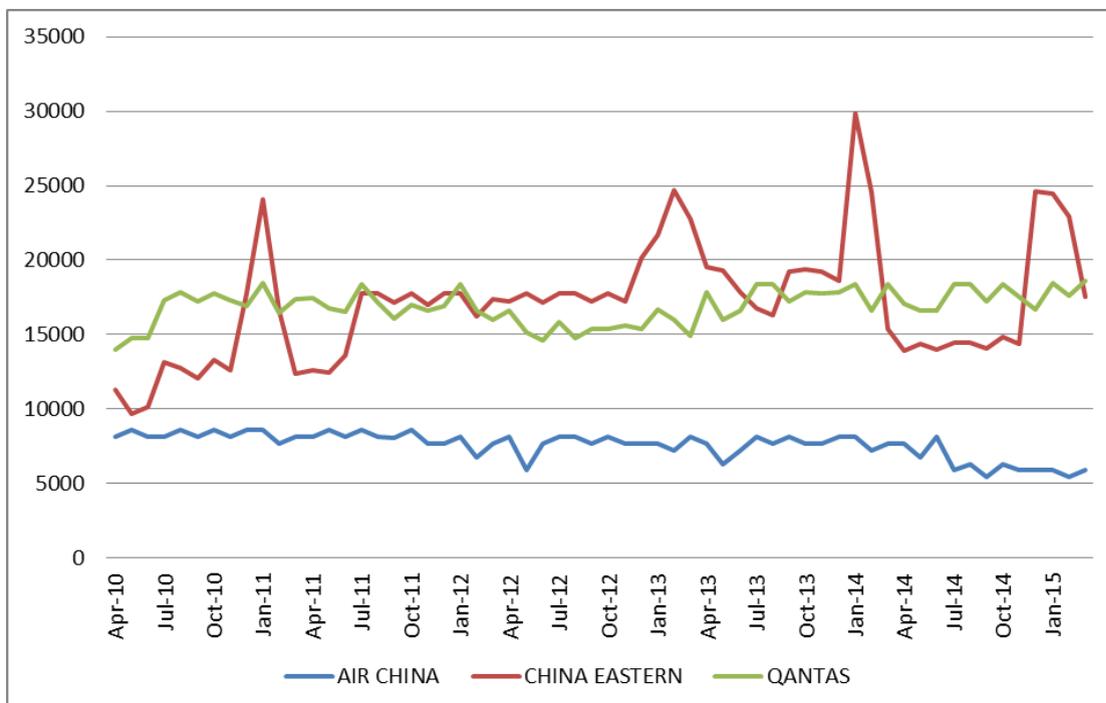


¹⁰ This figure includes Air China Sydney-Shanghai-Beijing flights.

¹¹ ACCC calculations based on information provided by the Bureau of Infrastructure, Transport and Regional Economics.

54. Between the year ended March 2011 and the year ended March 2015 seats flown on the route increased by 6%. Seats flown by Air China decreased by 31% and seats flown by China Eastern and Qantas increased by 24% and 6% respectively.

Graph 3: Total capacity Sydney – Shanghai (direct only)¹²



55. As well as direct flights operated by the Applicants and Air China, a number of indirect services are also offered. Indirect operators which operate services of less than 20 hours duration between Sydney and Shanghai with only one stopover include Cathay Pacific, China Southern, Malaysia Airlines, Singapore Airlines and Sichuan Airlines.
56. Cathay Pacific flights via Hong Kong (12:35 to 13:10 hours) have the shortest duration. This compares to direct flights of between 10:20 to 10:55 hours for Qantas, China Eastern and Air China.
57. In their initial submission in support of the Proposed Conduct the Applicants provided estimates that suggest that inclusive of indirect flights, Qantas and China Eastern had a combined share of passengers flown between Sydney and Shanghai for the year ending 30 June 2014 of 74%. According to this estimate, indirect flights account for around 12% of all passenger traffic between Sydney and Shanghai.¹³

¹² ACCC calculations based on information provided by the Bureau of Infrastructure, Transport and Regional Economics.

¹³ This assumes all Qantas, China Eastern and Air China passengers are traveling on direct flights. Some may in fact travel on indirect flights, particularly some Air China passengers as Air China only operates direct flights three days a week and some Qantas passengers travelling via Hong Kong.

Table 1: Total share of capacity and passengers Sydney – Shanghai: 1 July 2013 – 30 June 2014:

Source: Marketing Information Data Tapes (MIDT) data provided by the Applicants.¹⁴

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

58. Following concerns raised by the ACCC about the level of concentration on the Sydney – Shanghai route, Qantas submitted that the MIDT data they had originally provided is inaccurate and unreliable. Qantas stated that this data significantly understates the real share of indirect operators and does not correlate with Qantas' actual traffic data.
59. Qantas submitted that the MIDT data understates the real shares of indirect operators because the MIDT data:
- only captures bookings made with travel agents through the global distribution systems and attempts to estimate the number of bookings made directly with airlines
 - only captures bookings rather than journeys so that a passenger who chooses to make separate bookings for different segments of their journey will have those bookings recorded as separate journeys
 - only captures bookings that involve less than a 14 hour stopover so that a passenger who chooses to stay overnight in a destination (for example, Hong Kong) before undertaking onward travel will have their booking recorded as separate journeys
 - does not capture passengers who choose to fly to an airport and then proceed to their destination by a different means of transport (e.g. flights to Beijing followed by bullet train to Shanghai), and
 - does not capture passengers who fly to an alternative airport within the broader Shanghai catchment area.

¹⁴ This MIDT data is based on bookings made by travel agencies using the Amadeus global travel distribution system as well as an additional estimate of activity based on passengers making online bookings directly with airlines.

60. Therefore, Qantas provided its own, confidential, estimates of passenger shares inclusive of indirect traffic. Specifically, Qantas generated its own estimates of passengers traveling on indirect routes by comparing the number of Qantas passengers traveling from Sydney to Shanghai via Hong Kong reported in the MIDT data with the actual number of Qantas passengers flying this route.¹⁵ Qantas used the difference between the two to establish a multiple that Qantas then applied to the number of passengers recorded in the MIDT data on all indirect routes. However, Qantas did not undertake an equivalent exercise for passengers traveling on direct flights (Qantas assumed the MIDT data for direct flights was broadly correct).
61. The ACCC notes that any attempt to estimate shares of passengers flying on direct and indirect routes based on MIDT data must have regard to the extent of underreporting of passengers traveling on both direct and indirect flights in the MIDT data.
62. The ACCC accepts that passengers flying via indirect routes may be underreported (relative to those flying direct routes) in MIDT data because some of these passengers may have made separate bookings for separate legs of their journey. However, no information has been provided to suggest that such passengers would constitute a significant proportion of travellers on longhaul routes such as Sydney – Shanghai.
63. Passengers who choose to break up their journey with a stopover will also not be reported in the MIDT data. Some of these passengers will choose to take an indirect flight (for example, to take advantage of a cheaper fare) and as a consequence, decide to include a stopover in Hong Kong. Others will choose to include Hong Kong in their itinerary and select flights accordingly. The ACCC does not consider that the latter category of passengers should be included in any calculation of passengers travelling on the Sydney – Shanghai city pair route. For these passengers, direct flights between Sydney and Shanghai will be a weak substitute for indirect flights via Hong Kong.
64. Further, even if these passengers were to be included, calculating a difference ratio which includes passengers breaking up their journey in Hong Kong and applying it to all indirect flights between Sydney and Shanghai assumes that there is a similar demand for journeys incorporating a break on all indirect routes between Sydney and Shanghai.
65. Qantas also provided further revised estimates of airlines' shares of passengers which included passengers arriving at six other airports within what it terms the broader Shanghai catchment area. These airports are as far as 350 kilometres from Shanghai and the closest is 170 kilometres. The ACCC considers that flights arriving at these airports are likely to be only a weak substitute for Sydney – Shanghai flights and therefore has placed very little weight on these estimates.
66. In conclusion, there is no definitive source of data that would allow airlines' share of passengers between Sydney and Shanghai, inclusive of indirect flights, to be determined with certainty. However, the ACCC considers that based on the

¹⁵ Qantas used a different set of MIDT data to that noted at paragraph 57. In calculating its own estimates Qantas used MIDT data recording actual Qantas passengers travelling on the Sydney – Shanghai route (i.e. MIDT data excluding an additional estimate of activity based on passengers making online bookings directly with airlines).

available information the share of passengers travelling between Sydney and Shanghai on indirect flights is likely to be around 12% to 15%.

Air freight and mail services between Australia and China

67. Qantas operates the following dedicated freighter services, in addition to freight carried in bellyspace of passenger aircraft:
- from Sydney to Shanghai (via Bangkok and onwards to the US), twice weekly
 - from Sydney to Shanghai (via Chongqing and onwards to the US), weekly
 - from Sydney to Shanghai (onwards to the US), weekly
 - from Sydney to Shanghai direct twice weekly and
 - from Shanghai to Sydney direct, weekly.
68. China Eastern carries freight in the bellyspace of its passenger services but does not operate any dedicated freighters to or from Australia.
69. The Applicants state that in addition to bellyspace on passenger services direct into China (offered by carriers such as China Southern and Air China), Singapore Airlines operates six weekly dedicated freighters out of Australia, Cathay Pacific operates two weekly dedicated freighters out of Australia and Malaysia Airlines operates two weekly dedicated freighters out of Australia. The Applicants also submit that there are many specialised freight operators providing significant (one way, northbound) freight services from Australia to Asia, including DHL, United Postal Services Airlines and Federal Express.
70. In relation to freight, data provided by BITRE indicates that during 2010, Qantas carried around 43% of freight between Australia and China carried on direct flights and China Eastern carried 16%. In 2014 Qantas and China Eastern both carried around 20%. Between 2010 and 2014 China Southern's share of freight grew from 19% to 35%.
71. In relation to mail the proportion carried by each airline is reasonably volatile. In 2010, Qantas carried around 30% of mail between Australia and China carried on direct flights and China Eastern carried 8%. In 2014 Qantas carried 22% and China Eastern 2%. Between 2010 and 2014 China Southern's share of mail grew from 38% to 53%.

Consultation

72. The ACCC tests the claims made by an applicant in support of its application for authorisation through an open and transparent public consultation process.

Prior to the draft determination

73. The ACCC initially invited submissions from a range of potentially interested parties including competitors, airports, regulators, relevant government agencies, industry groups and service suppliers.¹⁶ In response, the ACCC received ten submissions either neutral, expressing qualified support or in support of the applications and one submission opposing the applications.
74. The National Tourism Alliance, Austrade, Tourism Victoria, Cairns Airport, Perth Airport and Melbourne Airport submitted that the Proposed Conduct would improve the ability of the tourism industry to attract Chinese tourism, a market on which the Australian tourism industry is focused. In particular, the coordination of the airlines' activities at Shanghai International Airport and increased flights and routes between Chinese and Australian city pairs were considered important.
75. The International Air Services Commission and the Department of Infrastructure and Regional Development provided details of the Applicants' current operations between China and Australia and those of their competitors.
76. Austrade, although generally supportive of the alliance, noted that there was a risk that the extent of overlap between the Applicants on the Sydney – Shanghai route could impact competition on the route. Austrade submitted that any authorisation should be granted subject to a condition requiring no reduction in services on this route by the Applicants. Virgin Australia, while noting the public benefits that can result from airline alliances, submitted that these benefits need to be considered against any potential competitive detriment in the context of Qantas and China Eastern's combined share of passengers on the Sydney – Shanghai route.
77. Jumpjet Airlines Limited expressed concerns that the alliance will inhibit the entry and expansion of domestic Australian airlines.

Following the draft determination

78. On 24 March 2015 the ACCC issued a draft determination proposing to deny authorisation to the Proposed Conduct.
79. The ACCC received further public submissions in response to the draft determination from the Applicants, Air China, the Department of Infrastructure and Regional Development (DIRD), Sydney Airport, Tourism and Events Queensland, the Hon. Warren Entsch, Ewen Jones MP, National Tourism Alliance, Jumpjet Airlines, Australian and International Pilots Association, Australia-China Relations Institute, the Australia China Business Council (Qld Branch), South Australian Tourism Commission, Tourism and Transport Forum, Brisbane Airport, Adelaide Airport, Australian Tourism Export Council, Tourism Australia, and MA Zhaoxu, Ambassador of the People's Republic of China to the Commonwealth of Australia.

¹⁶ A list of the parties consulted and the public submissions received is available from the ACCC's public register www.accc.gov.au/authorisationsregister.

The Applicants

80. In summary, the Applicants submitted that in the draft determination the ACCC:
- focused too narrowly on the Sydney – Shanghai route without sufficient regard to the broader dynamics of competition on routes between Australia and China
 - failed to appreciate the degree of competitive constraint imposed on the Applicants by carriers serving the Australia – China market via other hubs within and outside China
 - failed to appreciate the vigorous and effective competition provided by carriers operating indirect services on the Sydney – Shanghai route
 - construed ‘public benefit’ too narrowly and did not have sufficient regard to benefits accruing to Qantas. As a key Australian business and national icon, a strong and efficient Qantas is in the long term national interest, and
 - gave insufficient weight to the tourism and trade benefits flowing from the alliance.
81. The Applicants argued that the Proposed Conduct will facilitate a successful ‘gateway strategy’ by increasing the attractiveness of Shanghai as a hub for connecting services between mainland China and Australia and increase passenger flows in both directions. They also submitted that if the Proposed Conduct is authorised they will significantly increase the range of destinations covered by their codeshare agreement.
82. The Applicants also argued that the Proposed Conduct provides a framework for and incentives for enabling and expediting growth and investment in capacity on routes between Australia and China. The Applicants provided details of additional frequencies between Sydney and Shanghai, Melbourne and Shanghai and Cairns and Shanghai that China Eastern intends to operate and a new service they intend to operate, details of which are confidential, if the Proposed Conduct is authorised. These services are described in greater detail at paragraph 185.
83. The Applicants submitted that granting authorisation subject to a condition is unnecessary. However, to address the concerns set out in the ACCC’s draft determination the Applicants proposed a condition of authorisation that would require the Applicants to grow capacity on relevant routes. Details of the proposed condition were provided confidentially.

Interested parties

84. DIRD reiterated its earlier submission that the Proposed Conduct would, on balance, benefit Australian consumers. DIRD stated that the proposed alliance is consistent with the Australian Government’s aviation policy and benefits will include improving coordination of schedules and frequencies, sharing frequent flyer benefits between the Applicants, and allowing Qantas to offer its customers better access to destinations within China by reducing connection times for onwards flights from Shanghai. Further, the alliance will boost Australian tourism by increasing the ability of both airlines to market and sell tickets to Australian destinations.

85. DIRD submitted that the draft determination was too narrowly focused on the Sydney – Shanghai route rather than the operations of the wider Australia – China market. DIRD submitted that it is a commercial reality that an airline will have a significant market share on routes to and from its hub and this in itself should not prevent it forming alliances with other carriers when the consumer benefits can be shown to outweigh competitive impacts.
86. In addition, DIRD considered that there are few barriers to Air China increasing its capacity if the Applicants reduced or limited capacity on the Sydney – Shanghai route and there is also substantial scope for competitive response from carriers offering indirect services.
87. Air China submitted that competition between airline hubs servicing China is fierce and thus the focus of the ACCC’s assessment of the Proposed Conduct should be competition on all routes between Australia and China including indirect flights, rather than specific city pairs. In relation to the Sydney – Shanghai route Air China submitted that it has the ability to increase capacity and would also have the incentive to do so in response to any increase in fares or reduction in capacity that resulted from Qantas and China Eastern coordinating their operations on that route. Air China stated that it would have no incentive to engage in any sort of collusion (even tacit) with Qantas and China Eastern. Air China also argued that any price increases would not be sustainable because passengers would switch to flying through other gateways.
88. Sydney Airport and Tourism and Events Queensland emphasised the importance of China and Chinese resident passengers to Australian and their respective state’s tourism and trade. In particular, they noted that cooperative arrangements between airlines have the potential to enhance airline operations and provide travellers with additional flight options, improved schedules and new links to markets served by both carriers through enhanced connectivity. Sydney Airport expressed its support for initiatives which would significantly improve aviation links and services between Australia and China. Tourism and Events Queensland also stated that the Proposed Conduct would help the Applicants to better manage large fixed costs and volatile input costs, thus improving viability on Australia – China routes.
89. The National Tourism Alliance similarly emphasised the importance of China and Chinese resident passengers to Australian tourism and trade and noted the central role of aviation in Tourism Australia’s China 2020 Strategic Plan. The National Tourism Alliance submitted that broader Australia – China connectivity would improve trade generally and that access to a Chinese domestic hub will reduce transit times, improve products and connectivity, increase travel offerings and improve facilities and coordinated customer service.
90. The views of Tourism and Events Queensland and the National Tourism Alliance were echoed in essence in submissions received from the Australia – China Relations Institute, Brisbane Airport, South Australian Tourism Commission, Tourism and Transport Forum, Australian Tourism Export Council and Tourism Australia. The state tourism bodies also expressed concern that in the absence of the Proposed Conduct, the Applicants would be less likely to introduce new routes between non-Sydney airports and Shanghai.
91. There is currently no direct service between Brisbane and Shanghai. Brisbane Airport submitted that the proposed alliance will enable the commencement of a

Shanghai – Brisbane service far sooner than would otherwise be the case. Brisbane Airport argued that whether that service is operated by Qantas or China Eastern, or in partnership, will have no bearing on the level of competition on the Brisbane – Shanghai route in the foreseeable future, as the potential for two carriers to operate the route is very low.

92. Brisbane Airport submitted that while it supports the current Application it envisages that, as the Chinese overseas travel market grows and matures, there will come a time when it is no longer commercially critical for Qantas to operate in partnership with a Chinese airline. Therefore, it would be reasonable for the ACCC to approve the application now whilst reserving the right to periodically revisit the application.
93. The Australia China Business Council (Qld Branch) similarly submitted that the proposed alliance will increase the likelihood of Brisbane – Shanghai services commencing. They submitted that the absence of direct services on this route is a hindrance to greater trade and business development between Queensland and China.
94. Adelaide airport, which also currently has no direct services to Shanghai, also submitted that the proposed alliance will make direct flights between Adelaide and Shanghai more feasible in the future.
95. MA Zhaoxu, Ambassador of the People’s Republic of China to the Commonwealth of Australia submitted that travel between Australia and China is growing rapidly and that the proposed alliance will assist in meeting this growing demand to the benefit of both Australia and China.
96. Hon. Warren Entsch, Ewen Jones MP, DIRD and the National Tourism Alliance emphasised the importance of China and Chinese resident passengers to Australian tourism and trade, particularly in certain regions such as Northern Queensland, and argued that the proposed alliance is consistent with State and Federal Government policy objectives.
97. Jumpjet Airlines stated that authorisation should be denied on national interest grounds. By contrast, Australian and International Pilots Association (AIPA) expressed support for the Proposed Conduct on the basis that it would strengthen Qantas’ operations and thus improve its ability to operate as a national carrier.
98. The submissions by the Applicant and interested parties are considered as part of the ACCC’s assessment of the applications for authorisation.

ACCC assessment

99. The ACCC's assessment of the Proposed Conduct is carried out in accordance with the relevant net public benefit tests¹⁷ contained in the *Competition and Consumer Act 2010* (the CCA). In broad terms, the ACCC may grant authorisation if it is satisfied that the likely benefit to the public from the Proposed Conduct would outweigh the likely detriment to the public, including from any lessening of competition.

Relevant areas of competition

100. The Applicants submitted that, consistent with the ACCC'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. In particular, the Applicants submitted that 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.

101. However, to the extent that it is thought necessary to define a market or markets for the purpose of considering the competitive effects of the Proposed Conduct, the Applicants submitted that the appropriate markets are:

- the market for passenger air services between Australia and China and
- the market for freight air services between Australia and Asia.

102. The ACCC considers that the relevant areas of competition for the purposes of this assessment are:

- international air passenger transport services between Australia and China
- international air cargo transport services (freight and mail) between Australia and China and
- the supply of and procurement of various goods and services that form inputs to the supply of passenger and air cargo services in relation to which the Applicants seek authorisation to coordinate their activities (as listed at paragraph 13).

International air passenger transport services between Australia and China

103. The ACCC considers that the primary area of competition for the purpose of assessing the Proposed Conduct is international air passenger transport services between Australia and China.

104. Within this area of competition, the ACCC considers that it is also appropriate to examine the likely effects of the proposed alliance on competition and rivalry on

¹⁷ Subsections 90(5B), 90(7) and 90(8).

particular routes where necessary. In this instance, specifically the Sydney – Shanghai route being the one route on which the Applicants overlap with direct flights.

105. In response to the draft determination the Applicants and some interested parties submitted that the ACCC had focused too narrowly on the Sydney – Shanghai route without sufficient regard to the broader dynamics of competition on routes between Australia and China.
106. In considering the public benefits of the Proposed Conduct the ACCC has had regard to competition on routes between Australia and China. The ACCC's focus on the Sydney – Shanghai route in considering the public detriments of the Proposed Conduct reflects the ACCC's view that this is the only route on which competition concerns arise. The ACCC does not consider that services provided by carriers on other routes are a strong substitute for services on this route.
107. The ACCC notes the Applicants' argument that the Proposed Conduct will improve the ability of China Eastern's Shanghai hub to compete against other hubs for connecting services between mainland China and Australia (i.e. to destinations not serviced by direct flights). As discussed at paragraphs 202 to 212 the ACCC has had regard to this issue in assessing the Proposed Conduct.
108. In relation to the demand characteristics of travellers, the ACCC recognises that people travel for different reasons and can have substantially different demand characteristics. In general, passengers travelling for the purpose of leisure or visiting family and friends (leisure travellers) are relatively more price sensitive and relatively less concerned about factors such as travel time, frequency of flights, flexibility, connectivity, convenience and comfort when compared to business passengers. The manner in which airlines compete to attract leisure and business travellers differs, as does the willingness of these travellers to seek alternatives (such as for example, indirect flights). As a consequence, the effect of any lessening of competition on these customer segments can differ.
109. The ACCC considers that these characteristics of leisure and business passengers may mean that they each could be assessed separately as substantial parts of an overall market. However, in the context of considering these applications for authorisation, the ACCC considers that the assessment of public benefits and detriments in this matter is not significantly affected by whether business and leisure services are considered together or separately.

International air cargo transport services (freight and mail) between Australia and China

110. The ACCC considers that the product and geographic scope of the supply of these services is generally likely to be broader than the supply of international air passenger transport services (discussed above). In this regard, the ACCC notes:
 - customers can arrange to move cargo internationally from location A to location B (say, from Sydney to Shanghai) either in the hold of aircraft used for international passenger transport services or in the hold of dedicated freighter aircraft. Therefore, services offered by international passenger airlines and dedicated freighter airlines are also likely to be relevant and

- cargo transport customers are more likely (than passenger transport customers) to regard the direct and indirect service offerings of alternative service providers as close substitutes, since the 'inconvenience' of one or multi stop journeys is generally less of an issue for cargo than it is for passengers. Therefore, all routes between origin and destination, including via intermediate points in other regions, are included in the geographic scope.

Airline procurement of other goods and services

111. The Proposed Conduct extends to the Applicants jointly procuring products and services in the future, as detailed at paragraph 13. The Applicants state that they have not yet engaged in discussions to identify specific opportunities for joint procurement of particular goods or services in particular ports. They state that joint procurement is an area of coordination that will evolve over time once the Proposed Conduct commences.
112. No interested party has identified any impacts arising from the Applicants undertaking procurement jointly in the future.
113. The ACCC has had regard to the likely impact of the Proposed Conduct on the acquisition of various goods and services that form inputs to the supply of passenger and air cargo transport services (for example, inflight catering, corporate services, ground handling, aircraft maintenance and inflight entertainment and aircraft components) should the Applicants undertake joint procurement in the future.
114. The ACCC has also had regard to:
- the relatively large number of alternative acquirers of these products
 - the fact that many of the inputs are acquired on an international basis and
 - China Eastern being a relatively small acquirer of these services in Australia.
115. The ACCC, taking into account the information, evidence and submissions before it, considers that the Applicants' joint procurement of various goods and services is likely to have minimal, if any, impact on competition in any relevant market/area of competition. Accordingly, joint procurement is not considered further in this determination in assessing the public detriment likely to result from the Proposed Conduct.

Future with and without

116. To assist in its assessment of the Proposed Conduct against the authorisation tests, the ACCC compares the likely future with the conduct for which authorisation is sought and the likely future without the conduct the subject of the authorisation. The ACCC will compare the public benefits and detriments likely to arise in the future where the conduct occurs against the future in which the conduct does not occur.
117. The Applicants submitted that absent the Coordination Agreement:

- a) the Applicants will have no commercial incentive to co-locate terminals in Shanghai nor to provide enhanced reciprocal frequent flyer benefits
 - b) there will be increased marginalisation of Qantas in the Australia-China market as Qantas' presence in 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 Chinese passenger base
 - c) China Eastern will be unable to work with Qantas management and utilise its sales force in Australia to extend its network or provide better customer services.
118. In relation to Qantas' ongoing operations on routes between Australia and China, having considered all the information provided by the Applicants, the ACCC considers that absent the Coordination Agreement, the existing Codeshare Agreement between Qantas and China Eastern would be likely to be maintained. However, the ACCC considers that:
- the Applicants' incentives to co-locate terminals at Shanghai Pudong Airport would not be as strong
 - China Eastern would be unlikely to work with Qantas' Australian sales force in the manner envisaged and the level of coordination, such as on scheduling and reciprocal frequent flyer benefits, envisaged in the Coordination Agreement would be unlikely to occur, and
 - Qantas would be unlikely to form an alliance with an alternative North East Asian carrier.
119. With respect to Qantas' argument that it will become increasingly marginalised on routes between Australia and China, the ACCC notes that Qantas' share of passengers flown between Australia and China has decreased from 16.5% to 12.4% in the five years to March 2015. However, this is entirely as a consequence of the growth in the number of passengers traveling between Australia and China on routes on which Qantas does not operate its own flights. On the one route where it does operate its own point-to-point flights (i.e. Sydney-Shanghai), Qantas has increased its capacity over the five year period ending March 2015. More broadly, Qantas passenger numbers between Australia and China have grown between the year ended March 2011 and the year ended March 2015.
120. No material has been provided to the ACCC to suggest that, absent the Proposed Conduct, Qantas is likely to partner with an alternate Chinese carrier beyond its existing codeshare agreements. The ACCC also considers it unlikely that Qantas would undertake the necessary capital expenditure to expand its network through increasing the number of destinations in North East Asia to which Qantas operates flights. In particular, Qantas submits that it is not currently earning a return on capital on its own operations, primarily due to its high cost base and that the Proposed Conduct will provide the opportunity for it to expand its product offering and improve its profitability without the need for significant capital outlay.
121. On the information that has been made available to the ACCC, the ACCC considers that the most likely outcome absent the Proposed Conduct is that Qantas will continue to operate on the Sydney – Shanghai route and will increase

its capacity (seats flown) on the route in line with underlying demand if it is commercially viable for Qantas to do so. As noted, Qantas increased its capacity on the route by 6% between the year ended March 2014 and the year ended March 2015.

122. The ACCC also considers that Qantas and China Eastern would be likely to maintain their existing codeshare agreement. However, beyond the Sydney – Shanghai route, Qantas would be limited in its ability to respond to increased demand for services to and from North East Asia by increasing the scope of its network in the region. Specifically, Qantas would be unlikely to be able to expand its presence in North East Asia as effectively by relying entirely on codeshare agreements as it would under the proposed Coordination Agreement.
123. The Applicants have also argued that the Coordination Agreement will facilitate the expansion of China Eastern frequencies and destinations to Australia. This is discussed in the ACCC's assessment of the public benefits of the Proposed Conduct.

Public benefit

124. The CCA does not define what constitutes a public benefit and the ACCC adopts a broad approach. This is consistent with the Tribunal which has stated that the term should be given its widest possible meaning, and includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements ... the achievement of the economic goals of efficiency and progress.¹⁸

125. The ACCC's assessment of the likely public benefits from the Proposed Conduct follows.

Public benefits arising from airline alliances

126. The ACCC has authorised a number of airline alliances in recent years and recognised a range of public benefits arising from them, including enhanced products and services for consumers and efficiency improvements.
127. It is widely recognised that the realisation of potential public benefits from airline alliances depends on:
- how complementary the product and service offerings of the airlines concerned are. That is, the extent to which an alliance allows each airline in the partnership to access a greater number of geographic or product markets than they have access to absent that alliance. The degree of complementarity is determined by the number of destinations common to both networks. A high proportion of common destinations in the combined networks of alliance partners usually indicates a low degree of complementarity and vice versa
 - how strongly an alliance aligns the incentives of the parties so that they are driven to act in the interests of the alliance as a whole, rather than themselves. In alliances where the parties' incentives are fully aligned –

¹⁸ *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,242; cited with approval in *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,677.

to a point where each carrier is not concerned with making sure that a passenger flies on their airline (metal neutrality) – they tend to be very focused on synchronising their operations and activities and sharing the financial rewards and risks so as to make their products and services as appealing as possible to passengers and

- whether the alliance triggers a procompetitive response from rival carriers or facilitates spillover benefits to other areas of the economy (e.g. tourism).

128. In terms of network coverage and geography, the ACCC considers that, generally, the networks of Qantas and China Eastern are highly complementary. Both have extensive domestic and international networks including providing complementary opportunities for beyond travel (from Shanghai to Europe and the east coast of Australia to South America) while only overlapping on one direct route, Sydney – Shanghai.
129. The ACCC also considers that the product and service offerings of the two carriers are to some extent complementary. While both airlines are full service carriers, they have, to some extent, different customer mixes. Qantas passenger traffic has generally had a higher proportion of business passengers and oneworld alliance passengers than China Eastern; whereas China Eastern has had a greater proportion of Chinese based leisure travellers. Qantas provided Australian Bureau of Statistics (ABS) data which estimated that between May 2009 and April 2014 Qantas and China Eastern each had a 15% share of leisure travellers between Australia and China but Qantas had a 21% share of business travellers compared to China Eastern's 9%.
130. The ACCC has had regard to the airlines' complementarity in assessing the public benefits (and public detriments) of the Proposed Conduct below.
131. In relation to how strongly aligned Qantas and China Eastern's incentives are under the proposed Coordination Agreement, the ACCC notes that while the Proposed Conduct is not 'metal neutral,' their interests are more closely aligned under the Proposed Conduct than under the existing codeshare agreement.
132. Whether the alliance is likely to trigger a procompetitive response from rival carriers or facilitate spillover benefits will vary depending on the level of competition on relevant routes. This is discussed in considering the public benefits and detriments of the Proposed Conduct below.

Overview of public benefits claimed by the Applicants

133. Qantas and China Eastern submitted that the Proposed Conduct will result in the following public benefits:
- 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
 - improved products and services for customers travelling through Shanghai as a result of improved lounge facilities and coordinated customer service

- 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)
- expansion of the destinations covered under the existing codeshare agreement
- improved ability of China Eastern's Shanghai hub to compete against other hubs for connecting services between mainland China and Australia
- enhanced benefits for members of both Applicants' frequent flyer programs, particularly through increased earning and redemption opportunities
- improved reciprocal inventory access and inventory management, leading to a greater availability and variety of price points for consumers
- 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
- promote increased tourism in Australia, increased employment in Australia and enhanced international trade opportunities for Australian businesses and
- expedite the growth of China Eastern in Australia, leading to further employment in Australia and other economic benefits.

134. A number of the Applicants' public benefit arguments are based on a proposal to co-locate Qantas and China Eastern operations in Terminal 1 at Shanghai Pudong Airport, thereby allowing for the sharing of some passenger processing services and improving connectivity for Qantas passengers on onwards flights in China.

Assessment of public benefits

135. The ACCC has carefully examined the public benefits claimed by the Applicants and the evidence provided by the Applicants to substantiate those claims.

136. The ACCC has also taken into account the submissions and information received from interested parties in relation to the particular claimed public benefits. These submissions are discussed in relevant sections below.

137. As noted, the ACCC considers that if the Proposed Conduct does not proceed, Qantas and China Eastern's existing codeshare arrangement will likely continue. Therefore, in considering the public benefits likely to result from the Proposed Conduct, the ACCC's assessment is limited to consideration of any additional public benefits of the Proposed Conduct over and above those already resulting from the codeshare agreement.

138. The ACCC considers that the potential public benefits associated with the alliance fall into the following broad categories:

- enhanced products and services
- cost savings and other efficiencies
- triggering a competitive response from rivals
- stimulation of tourism and trade and
- enhanced and expedited growth in Australia by China Eastern.

Enhanced products and services

139. When airlines that provide complementary services act independently or less cooperatively, the effect that each airline has on the demand for the other airline's services is not taken into account by either party in planning products and services. The consequence of this 'externality'¹⁹ can include less convenient connections for passengers, higher fares/cargo charges due to double marginalisation, less attractive customer reward programs and/or lower levels of provision of ground services such as airport lounges and check-in services.
140. Cooperation agreements can provide a means to address this externality or inefficiency by enabling airlines to coordinate across complementary segments. Typically, this coordination occurs in areas including joint setting of schedules and fares/cargo charges and reciprocal access to value added services (frequent flyer schemes, frequent shipper schemes and airport lounges) between the airlines.
141. The ACCC considers that the Applicants are likely to have a greater ability and incentive under the Proposed Conduct than under their existing codeshare agreement to optimise their joint service offering and that this has the potential to result in public benefits.
142. Specifically, the Proposed Conduct has the potential to enhance the product and service offering of the Applicants in ways that are valued by consumers by facilitating:
- increased connectivity
 - better schedule spread
 - improved loyalty program benefits and
 - new frequencies and destinations.
143. This may also improve the ability of China Eastern's Shanghai hub to compete against other hubs for connecting services between mainland China and Australia.

¹⁹ An externality is an economic term referring to a cost or benefit that affects a third party (a party who did not agree to the action causing the cost or benefit) and is not reflected in market prices. In the presence of an externality, market prices do not reflect the full costs and benefits of producing or consuming a product or service. This results in an economic inefficiency or market failure.

Increased connectivity and convenience

144. The Applicants submitted that Qantas co-locating at the China Eastern Terminal in Shanghai will reduce transit times for passengers on Qantas flights by 90 minutes, thereby opening access to a far bigger range of one stop same-day connections using China Eastern's domestic network, including to destinations such as Chengdu, Dalian, Beijing and Xian.
145. Qantas' existing Sydney – Shanghai service arrives and departs at Terminal 2 at Shanghai Pudong airport. China Eastern is exclusively based at Terminal 1, both for operations from Australia and domestic operations within China. Passengers connecting between Qantas flights to Shanghai and China Eastern onward domestic flights are currently required to collect checked-in baggage, clear customs and proceed to transfer shuttles to move between Terminal 1 and Terminal 2 and re-check their baggage. The Applicants state that to facilitate this connection, a minimum connecting time of 2 hours 30 minutes is required whereas co-locating to Terminal 1 would reduce transit times to 60 minutes.
146. Based on the Northern Winter 2014 schedules, the Applicants submit that terminal co-location would enable Qantas passengers to have same day access to 56 additional frequencies to 9 destinations in China.
147. Data provided by Qantas indicates that currently less than 3% of passengers on Qantas flights transfer to a China Eastern flight on arrival in Shanghai. However, Qantas argues that this is due to the connectivity difficulties noted and that this figure can be expected to increase significantly if Qantas relocates to Terminal 1.
148. The ACCC recognises that increased access to existing frequencies and destinations is likely to represent a benefit for passengers on Qantas flights who transfer to a China Eastern flight in Shanghai for onward travel. The ACCC also recognises that co-location will benefit these passengers through increased customer convenience by avoiding the need to collect and recheck baggage and due to time savings associated with through-checking.
149. However, the ACCC also notes that for passengers who value connectivity and convenience this option is already available to them absent the Proposed Conduct. This is because passengers in Australia are already able to access the China Eastern frequencies and destinations noted by the Applicants by choosing to fly from Sydney to Shanghai with China Eastern rather than Qantas. Further, in respect of some of the onward destinations, passengers have the option of flying with other airlines and transiting through hubs other than Shanghai.
150. It follows therefore, that Qantas co-locating in China Eastern's terminal in Shanghai, in and of itself, is unlikely to increase the options available to passengers for beyond travel from Shanghai. Rather, it will improve the connectivity and convenience of these options for passengers who have a preference for flying with Qantas for the Sydney to Shanghai portion of their journey.
151. More generally, in the draft determination the ACCC noted that the Applicants had not specifically argued that the Proposed Conduct will improve connectivity of their services other than in relation to Qantas passengers transiting through Shanghai. However, the ACCC considered that allowing the Applicants to coordinate scheduling is likely to enable better scheduling of complementary

services, thereby facilitating greater connectivity between their services. The ACCC also noted that greater connectivity, and the possible closer alignment of the Applicants interests under the Proposed Conduct than under the existing codeshare agreement, may also provide improved opportunities and incentives for the Applicants to extend the domestic routes covered by their existing codeshare arrangements.

152. Following the draft determination the Applicants provided details of a significant expansion in the range of destinations that they submit will be covered by their current codeshare agreement if their proposed alliance proceeds. The proposed expansion covers many more domestic routes in both Australia and China than is currently the case.
153. The Applicants submit that this, coupled with joint marketing, will increase customer choices and drive more bookings and allow Chinese tourists to fly on China Eastern's code on Qantas operated flights beyond the major Australian gateways to more parts of regional Australia.
154. The ACCC considers that the expansion, under the proposed alliance, of the routes covered by the existing codeshare agreement is likely to provide passengers with an expanded range of online connections (passenger itineraries of two or more flight segments where connections are made between flights of the same airline, or its code share partners) for itineraries where passengers are currently required to use interline connection options (connection between two different codes).
155. The ACCC has previously recognised that customers value online connection options much more than interline connection options, noting that this is also acknowledged in the academic literature in this area.²⁰
156. To the extent that an airline alliance replaces interline connection options with online connection options for consumers, this may benefit consumers. These benefits may take several forms, including:
 - removal of the risk of forfeiting non-refundable fares if the first flight in a journey is delayed
 - increased convenience in not having to collect and bear baggage mid journey (where applicable)
 - time savings associated with through check (i.e. passengers do not need to allow time for a second check-in, where applicable) and better transit times due to coordination of the timing of connecting flights.
157. The ACCC also considers that expansion in the number of routes with online rather than interline connections is more likely with the Proposed Conduct than

²⁰ See, for example, Carlton, D., W. Landes, and R. Posner, 1980, 'Benefits and costs of airline mergers: a case study', *Bell Journal of Economics*, Vol. 11, pp. 65-83; Graham, D. R., D. P. Kaplan and D. S. Sibley 1983, 'Efficiency and competition in the airline industry', *Bell Journal of Economics*, Vol. 14, pp. 118-138; and Brueckner J. K 2003, 'International airfares in the age of Alliances: the effects of codesharing and antitrust immunity', *The Review of Economics and Statistics*, Vol. 85, No. 1, pp. 105-118.

without because the structure of the payments between the Applicants better aligns their incentives, allows them to sell the full range of inventory on each others' flights and because of the broader range of cooperation and coordination the Proposed Conduct provides for in relation to areas such as pricing, capacity, sales and marketing.

158. Expanding the number of routes where journeys can be booked on a single ticket (rather than requiring tickets to be booked with both airlines) is likely to also remove double marginalisation.
159. Double marginalisation is a situation that occurs where suppliers of vertically related or complementary products each enjoy a degree of market power and independently charge a price which includes a mark-up over their marginal costs and do not take account of the impact on the other firm's profit.²¹ The net result is both higher prices and lower profits than if the two firms coordinated their pricing, for example through vertical integration or a joint venture.
160. The ACCC considers that in theory, the extent of public benefit arising as a result of the removal or reduction of double marginalisation is likely to depend on:
 - the number of additional passengers that are expected under the proposed alliance to purchase onward (complementary) flights beyond and/or behind direct services between Australia and China, and
 - the degree of market power held by Qantas in the Australian domestic market and China Eastern in the Chinese domestic markets. This would be reflected in the magnitude of the mark-up above cost that these airlines currently realise on specific routes.
161. The ACCC considers that any removal of double-marginalisation under the Proposed Conduct would be a benefit to passengers who utilise a connection in Australia or a connection in Shanghai that involves flights operated by both Qantas and China Eastern.
162. The extent of benefit available to these passengers is likely to vary across routes.
163. The ACCC considers the removal of double marginalisation under the Proposed Conduct is a benefit to the Applicants' passengers, and should lead to lower prices for journeys connecting separate services operated by each of the Applicants. The ACCC considers that the magnitude of this benefit is not readily quantified. However, the removal of double marginalisation is likely to result in some public benefit.

Better schedule spread

164. Airline alliances can improve customer choice by spreading flight schedules in situations where the airlines currently fly wingtip to wingtip. Wingtip flying occurs because there are certain times preferred by a large number of passengers and each airline, acting independently, will endeavour to cater to these preferences. Under an alliance with revenue sharing, their incentives change and they may find the retiming of one flight to be more consistent with joint revenue maximisation.

²¹ The ACCC notes that in practice all firms have some degree of market power and charge a price which is above marginal cost. That is, all firms face a downward sloping demand curve

165. The Applicants submitted that the Proposed Conduct will facilitate schedule optimisation and they intend to identify opportunities to deliver customers a broader choice of departure and arrival times throughout the day, enabling greater choice of onward flight connections.
166. For example, currently, Qantas and China Eastern flights from Sydney to Shanghai depart at 9:35 and 11:00 respectively. Return flights from Shanghai depart at 19:55 and 20:20.²² Under the proposed alliance, the Applicants submitted that the intention would be to further spread arrival and departure times, potentially enabling both morning and evening departures in both Sydney and Shanghai. They argued that this will provide customers with greater choice and flexibility of flight times.
167. The ACCC considers that wingtip flying often reflects competition between airlines during peak periods. By aligning flight schedules during peak periods airlines are able to maximise the number of potential customers and, hence, individual revenues or profits. However, the public is likely to benefit from a wider variety of schedules to the extent that passengers who would prefer to fly earlier or later have the option of doing so.
168. The ACCC considers that Qantas and China Eastern spreading departure times on the Sydney – Shanghai route would provide greater choice for some passengers and is likely to represent a public benefit. However, the ACCC notes that there is less likelihood that Qantas and China Eastern would agree to spread their departure times under the Proposed Conduct than there would be under a metal neutral alliance. Under the proposed Coordination Agreement, Qantas and China Eastern will retain incentives to favour their own flights over each other's, which reduces the incentives for either to agree to move their flight from the peak demand time.
169. Further, any benefit from spreading departure times may be accompanied by a detriment for people who prefer to travel in the wingtip times, but may be unable to do so if no rival airline steps in to meet unmet demand at peak times. This would both provide an opportunity for the Applicants to raise prices in peak times and mean that the preferences of some passengers to fly at peak times are not met.
170. More generally, the further information provided by the Applicants in response to the draft determination does not indicate that they intend to spread the departure times of their existing Sydney – Shanghai flights. The Applicants propose for the upcoming Northern Winter 2015 to schedule Qantas and China Eastern flights from Sydney to Shanghai which will depart at 10:50 and 12:00 respectively. Return flights from Shanghai will depart at 20:05 and 20:20.
171. As discussed at paragraph 185, China Eastern does propose to add an additional Sydney – Shanghai service. This service will depart Sydney at 21:30 and Shanghai at 23:55. As a consequence, passengers will have a greater choice of departure times which the ACCC considers to be a public benefit. However, this greater choice of departure times is as a consequence of the additional service, which China Eastern will operate at a differentiated time from its existing service, rather than any coordination of departure times between Qantas and China Eastern.

²² Based on Northern Summer 2015 schedules.

Improved loyalty program benefits

172. The ACCC has previously accepted that there are public benefits from increased opportunities for passengers of alliance partners to earn and redeem frequent flyer points on each other's flights.
173. Qantas and China Eastern have an existing arrangement under which members of each Applicant's frequent flyer program can earn and redeem frequent flyer points on the other Applicant's services. However, they submit that there are currently limited earn opportunities and very little redemption activity.
174. The Applicants argued that the Proposed Conduct will result in members of both Applicants' frequent flyer programs having increased opportunities to earn and redeem points on their respective networks. They also submitted that the Proposed Conduct provides the commercial incentive for the Applicants to improve the frequent flyer proposition and customer experience for each airline's customers, particularly those with a particular membership tier status.
175. The ACCC sought further information about these claimed benefits from the Applicants. In particular, the ACCC sought details about any loyalty program benefits that the Applicants proposed to introduce in addition to those currently provided through the codeshare agreement between Qantas and China Eastern.
176. In response, the Applicants submitted that some of the potential benefits for eligible members that may be agreed and implemented over time include: priority check-in, additional checked baggage allowance, priority boarding, lounge access, and on-board recognition. The Applicants also submitted that the Proposed Conduct is likely to provide the incentive to engage in cross promotional activities using each others' membership base (such as offering bonus points to stimulate demand) and other joint marketing activities.
177. The ACCC considers that the attractiveness of the Applicants' loyalty programs are likely to be enhanced under the alliance, primarily by increased access to existing China Eastern frequencies and destinations. In this respect, the ACCC notes the proposed significant expansion in the number of routes covered by the Applicants' existing codeshare agreement, as discussed at paragraph 152. Given the large number of frequent flyer members and the range of benefits that might accrue to them, this is likely to result in a public benefit.
178. Further, there may be more opportunities for the additional initiatives noted at paragraphs 174 and 176 to be implemented under the Proposed Conduct. While such initiatives could be adopted under the existing codeshare agreement, as discussed at paragraphs 140 to 142, the ACCC considers that the Applicants' incentives to do so may be stronger under the Proposed Conduct.

New frequencies and destinations

179. There has been substantial analysis undertaken about the relationship between airlines' product and service quality and passenger demand.²³

²³ See, for example, Ippolito, R. A 1981, 'Estimating airline demand with quality of service variables', *Journal of Transport Economics and Policy*, Vol. 15, No. 1, pp. 7-15; Suzuki, Y., Tyworth, J. E. and R. A. Novack 2001, 'Airline market share and customer service quality: a reference-dependent model',

180. Consistent with this analysis, the ACCC has previously accepted that the additional passenger traffic stimulated by an alliance can lead to the introduction of new frequencies, new direct services and/or new destinations, which give rise to further public benefits through increased choice and convenience relative to the future without the proposed conduct.
181. Prior to the draft determination the Applicants submitted that by being able to combine load volumes, they expected that by 2016 China Eastern will be able to operate 24 flights (12 return services) a week between Sydney to Shanghai and 22 flights (11 return services) per week between Melbourne and Shanghai (up from 9 return services per week between Sydney and Shanghai²⁴ and 7 return services per week between Melbourne and Shanghai²⁵ based on the Northern Winter 2014 Schedule). They also submitted that the alliance will provide the basis for the Applicants to explore opportunities to introduce new services between Brisbane and/or Perth and Shanghai.
182. In the draft determination the ACCC considered that there is a greater prospect of some new frequencies, direct services and destinations in the future with the Proposed Conduct (relative to the future without it) as a result of combining load volumes. The ACCC recognised that this could be further enhanced if the Applicants were to undertake joint marketing initiatives which could potentially stimulate additional passenger traffic. The ACCC also recognised that to some degree, the extent of opportunities to provide additional frequencies and new destinations as a result of the Proposed Conduct may not be readily identifiable, or at least quantifiable, until the Coordination Agreement comes into effect.
183. However, in the draft determination the ACCC noted that the Applicants had provided no evidence in support of these claims either in their submission in support of the Proposed Conduct or following a request from the ACCC for further information about this claimed public benefit. Rather, the Applicants had made general assertions about increases in frequencies without any supporting material.
184. Therefore, the ACCC concluded in the draft determination that while there is the potential for some new frequencies, direct services and destinations in the future with the Proposed Conduct, which is potentially a source of public benefit, the Applicants had not provided sufficient evidence for the ACCC to conclude that this is a likely, as opposed to a possible, outcome from the Proposed Conduct.
185. In response to the draft determination the Applicants provided more specific details about the proposed new services they submit they will initially introduce if the Proposed Conduct is authorised. Specifically, the Applicants stated that if authorisation is granted China Eastern will introduce:

Transportation Research Part A: Policy and Practice, vol. 35, Issue 9, November, pp. 773-778; and Lederman, M. 2008, 'Do enhancements to loyalty programs affect demand? The impact of international frequent flyer partnerships on domestic airline demand', *The Rand Journal of Economics*, Vol. 38, Spring, pp. 1134-1158.

²⁴ From 27 October 2014 to 4 March 2015 China Eastern operated additional frequencies between Sydney and Shanghai with 14 return services per week. This reduces to 9 return services per week from 3 April 2015.

²⁵ China Eastern operated an additional daily flight each way on the Melbourne – Shanghai route between 30 November 2014 and 9 March 2015.

- a year round service on a new route, details of which were provided to the ACCC on a confidential basis, and
 - additional frequencies between Shanghai and each of Sydney, Melbourne and Cairns. Specifically:
 - on Sydney – Shanghai, an A330 aircraft initially operating three times a week from September 2015, moving to daily in November 2015 until 29 February 2016, and again for equivalent periods in subsequent years
 - on Melbourne – Shanghai, an A330 aircraft initially operating three times a week from September 2015, moving to daily in November 2015 until 29 February 2016, and again for equivalent periods in subsequent years, and
 - on Cairns – Shanghai, an A330-200 aircraft on a seasonal basis from 15 January 2016.
186. The Applicants also argued that the Proposed Conduct will increase the potential for Qantas to deploy new capacity between Australia and China.
187. The Applicants confirmed that the additional frequencies between Shanghai and each of Sydney and Melbourne will not be added every day between November and the end of February each season. Rather, they will be added on days where China Eastern does not already fly twice a day. In this respect the ACCC notes that China Eastern flew a second daily flight between Shanghai and Sydney on 80 days and a second daily flight between Shanghai and Melbourne on 32 days in 2014.
188. The Applicants submitted that the additional frequencies between Shanghai and each of Sydney and Melbourne will be extended to year round operations if demand is sufficiently stimulated as a result of the Proposed Conduct. In this respect, they submitted that adding additional capacity in peak periods is standard practice to both test the sustainability of increased services in new and existing markets and ascertain the stimulatory effect on demand.
189. The Applicants stated that there is no intention to add this capacity in the short to medium term if the Proposed Conduct is not authorised. In this respect the Applicants stated any increase in capacity generates unavoidable costs and risks that need to be considered by the Applicants. They argued that the terms of the Joint Co-ordination agreement have the effect that Qantas subsidises and supports China Eastern operations which de-risks their expansion plans in a way that would not occur absent the Proposed Conduct.
190. The Applicants also stated that new capacity is made more sustainable when it can be linked to behind and beyond networks, providing access to larger traffic pools, as is proposed by them.
191. As noted above, in the draft determination the ACCC accepted that there is a greater prospect of some new frequencies, direct services and destinations in the future with the Proposed Conduct (relative to the future without it) as a result of combining load volumes. The ACCC's concern in attaching weight to this

argument was the lack of sufficient evidence for the ACCC to conclude that this was a likely, as opposed to a possible, outcome from the Proposed Conduct.

192. The ACCC also accepts that the financial payment terms of the Joint Coordination Agreement lessens the commercial risk to China Eastern in undertaking capacity expansion. Further, the expansion of the codeshare routes proposed under the alliance (as discussed at paragraphs 152 to 163) will also promote greater traffic on point to point routes between Australia and Shanghai and thereby contribute to underpinning the viability of expanding capacity on those routes.
193. The ACCC also considers that, as submitted by the Applicants, adding additional capacity in peak periods can be used to test demand and ascertain the viability of additional year round services. However, in this respect, the ACCC notes that China Eastern has been steadily increasing the number of days over peak periods on which they offer a second daily services on the Sydney – Shanghai route, and to a lesser extent on the Melbourne – Shanghai route, over the last few years without the Proposed Conduct in place. For example, in 2012 China Eastern operated 366 flights between Sydney and Shanghai. In 2013 they operated 429 flights and in 2014 they operated 445. The proposed additional services on these routes outlined above continue this trend. The Applicants also currently operate a seasonal service on the Cairns – Shanghai route and have done so for the last three years. More generally, the proposed growth in frequencies that the Applicants have advised the ACCC about, when considered over the five year term of the authorisation sought, is broadly consistent with their historical growth rates.
194. Accordingly, notwithstanding the Applicants' submission that that there is no intention to add this capacity in the short to medium term if the Proposed Conduct is not authorised, it is not clear that services on these routes would not continue to be added without the Proposed Conduct in place.
195. However, the ACCC does note that China Eastern proposes to add all this capacity over the first two years of the alliance. Considered over this timeframe the proposed capacity expansion does represent a significantly higher rate of growth in capacity by the Applicants than has been the case in the recent past.
196. The ACCC also notes the Applicants' submission that these additional frequencies may be extended further in the future if passenger demand is sufficient. Accordingly, while the Applicants have not committed to add further additional capacity beyond 2017, they may in fact do so depending on the success of the additional frequencies they initially propose to add.
197. As noted, the ACCC considers that adding capacity incrementally in peak periods can be a precursor to more substantial, year round, additional services. The ACCC accepts that decisions about adding additional capacity beyond that currently proposed will be driven by market conditions and passenger demand, including the impact of the initially proposed capacity additions on passenger demand. The ACCC therefore accepts that the Applicants may not wish to commit to further capacity additions beyond the first two years of the term of authorisation sought until closer to the time that further capacity may be added. Particularly in the context where, as discussed at paragraphs 360 to 384, the ACCC is imposing conditions of authorisation requiring the Applicants to grow capacity at a rate set having regard to their planned capacity expansion.

198. However, having regard to trends in historical growth in capacity, if the Applicants' arguments about the Proposed Conduct facilitating the addition of greater frequencies than would be the case absent the Proposed Conduct are correct, the ACCC expects that this would be reflected in increases in capacity. In particular, the ACCC would expect capacity increases of a significantly greater magnitude on these routes, over the five year term for which authorisation is sought, than the Applicants currently propose to add over the first two years.
199. In relation to the new route China Eastern proposes to add, it intends to offer year round services from the outset which represents a significant capacity commitment. The ACCC considers that, for the reasons noted above, China Eastern would be more likely to make a capacity commitment of this magnitude with the Proposed Conduct in place than without it.
200. In summary, the ACCC considers that the additional frequencies and destination proposed by the Applicants represent a significant public benefit. What is less clear is the extent to which this public benefit can be wholly attributed to the Proposed Conduct (i.e. the extent to which China Eastern would add additional frequencies without the alliance in place). However, the ACCC considers that expansion in capacity of the magnitude contemplated is more likely to occur, or occur sooner than would otherwise be the case, with the Proposed Conduct.
201. Notwithstanding this, as noted, the ACCC expects that successful implementation of the gateway strategy underpinning the Applicants' public benefit arguments should result in significant additional growth in capacity above that which the Applicants currently propose. If this were not the case, it may be difficult for the ACCC to accept that the alliance facilitates the addition of new frequencies and destinations and the development of Shanghai as a gateway to greater China for Qantas and China Eastern in any application for re-authorisation.

Hub competition and triggering a competitive response from rivals

202. The Applicants submitted that the alliance will benefit consumers by provoking competitive fares, products and service offerings from rival carriers. In particular, the Applicants submit that competition between hubs to attract passengers transferring into greater China is intense. The Applicants submitted that by facilitating a successful 'gateway strategy' for both Qantas and China Eastern the Proposed Conduct will increase the attractiveness of Shanghai as a hub for connecting services between mainland China and Australia. They submit that this will dramatically improve the ability of Shanghai to compete against other hubs such as Hong Kong (Cathay Pacific), Singapore (Singapore Airlines), Beijing (Air China), and Guangzhou (China Southern) and lead to greater passenger growth than would otherwise be the case.
203. The Applicants stated that it would not be feasible for Qantas to achieve this gateway strategy with another Chinese carrier in a port to which Qantas does not fly or has no intention of operating, particularly in a market like China which has its strongest growth activity orientated around secondary interior markets.
204. Qantas provided examples of capacity additions and marketing initiatives undertaken by other airlines since the Proposed Conduct was announced which it submits illustrates a competitive reaction from rivals to the Proposed Conduct. In particular, Qantas highlighted announced increases in flights and/or expansion into new routes between Australia and China by Chinese airlines.

205. The ACCC considers that there is strong competition between airlines operating out of hubs within and outside of China for the many passengers traveling between Australia and points in China not serviced by direct flights. Choice of airline (and hub) for these passengers will be influenced by a range of factors including price, travel time and airline and airport services and amenities. In this respect, the increased connectivity and convenience and increased frequencies likely to result from the Proposed Conduct mean that China Eastern (and Shanghai) will be a more attractive proposition for some of these passengers.
206. However, the ACCC notes that the competition from other hubs, which the Applicants have described as intense, is provided by airlines (and hubs) none of which currently has an alliance with an Australian carrier. Accordingly, the ACCC does not consider that such an alliance is an integral driver to this competition.
207. The ACCC notes the examples provided by Qantas about capacity additions and marketing initiatives recently undertaken by other airlines. The ACCC considers that these reflect existing competition between airlines on routes between Australia and China. These additions are consistent with the growth in demand for and supply of airline services on these routes in recent years.
208. While the proposed alliance will enhance the Applicants product and service offering, and thereby their ability to compete with rival airlines, the ACCC does not consider that there is sufficient evidence to conclude that a public benefit, in the form of triggering a competitive response from rivals, is likely to arise. Rather, the ACCC considers that rival airlines will continue to strongly compete for passengers transferring into greater China with or without the alliance in place.
209. In relation to Sydney – Shanghai point to point passengers, as discussed in the ACCC's assessment of the public detriments of the Proposed Conduct, the ACCC considers that entry or expansion on this route is unlikely and that Air China and indirect flights are likely to be a significantly weaker competitive constraint on Qantas and China Eastern than they are on each other. Therefore, the ACCC does not expect that the Proposed Conduct will promote competition on this route.
210. More generally, the Applicants have argued that strengthening Shanghai as a hub, in itself, constitutes a public benefit. However, the public benefits resulting from increased connectivity and convenience and increased frequencies through Shanghai have already been recognised above. It is unclear that improving the attractiveness of Shanghai as a hub, in and of itself, would constitute an additional public benefit distinguishable from any public benefit attributable to increased connectivity and convenience and increased frequencies.
211. Further, the ACCC would expect that to the extent that the Applicants expect that the Proposed Conduct will allow them to compete more effectively with other hubs this would be reflected in an expectation of significant additional traffic on flights operated by them between Australia and China. As discussed above, the additional capacity the Applicants currently propose to add is broadly consistent with their historical capacity expansion and does not appear to accord with an expectation that the Applicants will capture a significantly greater proportion of passengers traveling into greater China than in currently the case or stimulate significant additional demand for services into greater China.
212. The ACCC has imposed conditions of authorisation requiring the Applicants to report each scheduling season about the number of passengers carried on each

route between Australia and China. If, as the applicants submit, the Proposed Conduct facilitates the development of China Eastern's Shanghai hub as a gateway to greater China for Australian passengers the ACCC expects this to be reflected in this reporting. Were this not the case this would call into question the Applicants' arguments about the Proposed Conduct facilitating this gateway strategy. This will be an important consideration in the ACCC's assessment of any application for re-authorisation.

Cost savings and other efficiencies

213. In the past the ACCC has accepted that improved operating efficiency and/or avoidance of duplicated fixed costs through airline alliances are likely to result in a public benefit. However, the ACCC has generally not placed significant weight on this public benefit absent strong evidence from the Applicants about how such savings will be achieved.
214. The Applicants have submitted that Terminal 1 co-location will allow them to share lounge facilities as well as customer transfer operation facilities. In respect of freight, they submit that the proposed alliance will facilitate streamlined customs duty processes and remove the need for repackaging and relabeling of freight as it will be transported via one combined network.
215. More generally, the Applicants have identified activities on which they may coordinate in the future that may lead to cost savings as including sales and marketing, holiday products and packages, distribution, agency arrangements, airport services and joint procurement.
216. While noting that joint procurement is an area of coordination that will evolve over time once the Proposed Conduct commences, the Applicants have identified the following goods and services as those in relation to which joint procurement is likely to be cost effective and efficient: inflight catering, lounges, logistics, corporate services, inflight goods and services, crew accommodation, labour hire, airport charges, fuel, ground handling, aircraft maintenance, inflight entertainment and aircraft components.
217. The ACCC considers that co-location in Terminal 1 is likely to result in cost savings and represents a source of public benefit. In particular co-location in Terminal 1 is likely to enable more efficient management of transiting customers and the sharing of lounge, ground handling, flight check in, gate arrival and departure services. It will also streamline the processing of freight being transported to Shanghai by Qantas and then onwards by China Eastern.
218. More generally, the ACCC considers that the Proposed Conduct has the potential to realise cost savings in the other areas identified by the Applicants as summarised in paragraphs 215 and 216 (i.e. other areas of joint coordination and joint procurement). However, noting that no decision has yet been made by the Applicants about whether they will coordinate in relation to any of these activities, the extent of any potential cost savings and efficiencies, is unclear.

Stimulation of tourism and trade

219. A number of interested parties support the alliance on the basis that it will have benefits for Australian trade and tourism. In particular, as summarised at paragraph 74 and paragraphs 88 to 96 a number of tourism bodies, airports, and

other interested parties submitted that the Proposed Conduct would contribute to the tourism industry's ability to attract visitors from China, a market on which the Australian tourism industry is focused, and would benefit trade relationships.

Tourism

220. The Applicants submitted that the Proposed Conduct will generate increased levels of inbound travellers to Australia, in particular because they will engage in joint advertising campaigns and leverage Qantas' overseas profile and China Eastern's sales and marketing presence in Australia. The Applicants further stated that 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.
221. In previous decisions the ACCC has recognised that airline alliances can stimulate tourism by (i) making Australia more accessible or convenient as a tourist destination by enhancing the alliance's product and service offering, and (ii) allowing the parties to exploit synergies through joint rather than separate tourism promotion activity.
222. The ACCC recognises that promotion of Australia as a tourist destination has public good characteristics.²⁶ Investments in promoting Australia as a tourist destination can not only benefit the party undertaking that investment (for example, Qantas or China Eastern), but also other parties that offer services to tourists (such as hotels, tour operators and other airlines). As private parties are unable to appropriate the full benefits from their tourism promotion activity, there is likely to be under investment in such activity, at least from society's perspective. To the extent that this market failure is not addressed by Australian governments providing and/or subsidising activities to promote Australia, the ACCC accepts that any change in the incentives for airlines to make further or better targeted investment in the promotion of Australia as a destination for tourists, conferences and trade events that may occur under an alliance is likely to bring about a more optimal level of investment in promotion activity.
223. The ACCC considers that the level of tourism-related public benefits attributable to the Proposed Conduct depends on the likely impact of the Proposed Conduct on demand for tourism in Australia and on expenditure by tourists on Australian goods and services once they arrive.
224. As the ACCC has noted previously, there are a wide range of factors which influence tourism demand and expenditure, including general purchasing power in source countries, the relative cost of other destinations, the total cost of visiting Australia and the perceived quality of Australia as a destination.

²⁶ Public goods are non-excludable and non-rivalrous, which means that individuals cannot effectively be excluded from using the good and use by one individual does not reduce its availability to others. Other examples of public goods include street lighting, clean air and free to air television. Left to their own devices, markets can fail to achieve the socially desirable level of investment in the good because people that benefit from it can continue to do so without paying for it. This market failure may be addressed through government provision or sponsorship of the good.

225. In this case, the ACCC notes that a variety of factors, including initiatives such as the Australian Government's Asia Marketing Fund²⁷ and Tourism Australia's Key Distribution Partner Program²⁸, are likely to influence inbound tourism demand.
226. Further, the ACCC notes that the proposed Coordination Agreement is not metal neutral, meaning Qantas and China Eastern will continue to have some incentive to sell tickets on their own operated flights over those of their partner airline. Incentives to undertake investment in joint tourism initiatives will not be as strong in these circumstances as under a metal neutral alliance. For similar reasons to those discussed above, each partner will be more reluctant to contribute to such investment where the benefit of doing so (increased sales) may be captured disproportionately by their partner airline.
227. However, the ACCC does consider that by increasing the connectivity and convenience of the Applicants' services and expanding the frequencies and destinations offered by them the Proposed Conduct does have the potential to promote greater levels of inbound tourism to Australia. In particular, the expansion of the routes covered by the existing codeshare agreement will provide greater connectivity for China Eastern passengers to a wider range of Qantas domestic services.
228. In summary, the ACCC considers that the Applicants' improved product and service offering under the Proposed Conduct has the potential to promote tourism to Australia to an extent. However, having regard to the range of other factors that are likely to be more significant determinants of inbound tourism numbers, and the alternative options available to many potential Chinese tourists wishing to visit Australia (in the form of services provided by other airlines) the ACCC does not consider that the impact of the Proposed Conduct on Australian tourism is likely to be significant.

Trade

229. The Applicants submitted that the proposed alliance will strengthen the bilateral relationship between Australia and China. More specifically, they submit the alliance will enable Australian exporters to more readily access their combined network and significantly increase trade opportunities for Australia. They note that China is Australia's largest two-way trading partner in goods and services, largest goods export destination and largest source of merchandise imports.²⁹
230. The Applicants also submitted that the China-Australia FTA, announced on 17 November 2014, will encourage new Chinese investors to invest in sectors such as infrastructure and agriculture, promoting tourism and building linkages in agricultural research. They noted statements by the Department of Foreign Affairs and Trade that concluding the FTA will provide extensive opportunities to

²⁷ The Asia Marketing Fund was announced by the Australian Government in the 2012-2013 Budget and provides \$48.5 million over four years to promote Australia as a tourism destination to the markets of Asia.

²⁸ Tourism Australia's Key Distribution Partner Program was announced in July 2014 and is 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 growing middle class in China.

²⁹ Department of Foreign Affairs and Trade, *China Country Brief*
<http://dfat.gov.au/geo/china/Pages/china-country-brief.aspx> as at 16 February 2015.

Australian businesses, removing barriers to trade with Australia's biggest market for services, resources and agriculture.

231. The ACCC has previously recognised the potential for airline alliances to confer trade related public benefits, particularly when they provide for cooperation in relation to passenger and cargo services.
232. The ACCC considers that the level of trade-related public benefits attributable to the Proposed Conduct depends on the likely impact of the Proposed Conduct on the volume and value of (non-tourism) trade between Australia and China.
233. However, the key drivers of the volume and value of (non-tourism) trade between Australia and China are largely outside the influence of airlines. They include, for example, purchasing power in source countries, the relative prices of goods and services, consumer tastes and preference, 'ease of doing business', and stability of government.
234. Therefore, the ACCC considers that any net positive impact on trade as a result of the Proposed Conduct is likely to be small.

Enhanced and expedited growth in Australia by China Eastern

235. The Applicants submit that China Eastern has already made a substantial contribution to the Australian economy since it first commenced services to Australia and that the proposed alliance will strengthen and expedite the platform for China Eastern's capacity growth in Australia. They submit that 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).
236. The ACCC considers that, to the extent that the alliance stimulates growth in China Eastern's Australian operations, then there is a potential for some, likely limited, (gross) public benefits under this category. The alliance could do this by stimulating overall demand for labour and for airline business inputs in the Australian economy. This may lead to higher (real) incomes to Australian workers and businesses.
237. The ACCC notes however, that the net public benefit is likely to be less than the increase in (real) incomes generated by China Eastern's increased activity in Australia if other airlines reduce their activity in Australia as a result of the alliance. Moreover, any net effect of growth in China Eastern's Australian operations would be driven primarily by increased passenger traffic between Australia and China. It is unclear that any such net effect would constitute an additional public benefit distinguishable from any public benefit attributable to increased tourism and trade as a result of the Proposed Conduct.

ACCC conclusion on public benefits

238. The ACCC considers that the alliance is likely to result in public benefits by providing passengers on Qantas flights from Sydney to Shanghai with improved connectivity and convenience when transferring to a China Eastern flight for onward travel and vice versa. In particular, the Proposed Conduct is likely to facilitate a significant expansion in the destinations covered by the Applicants

existing codeshare agreement making connectivity between the Applicants existing services for passengers easier and more seamless.

239. More generally, the Proposed Conduct is also likely to enable better scheduling of complementary services by the Applicants, thereby facilitating greater connectivity between their services. Co-location at terminal 1 in Shanghai will also facilitate greater connectivity for passengers traveling on Qantas flights to Shanghai and then transferring to a China Eastern flight for onward travel. However, this benefit is only likely to accrue to passengers who have a preference for flying Qantas for the Sydney – Shanghai leg as passengers are already able to fly with China Eastern directly, or with another airline through a different hub.
240. Expanding the number of routes where journeys can be booked on a single ticket should also lead to lower prices for passengers utilising a connection that involves flights operated by both Qantas and China Eastern. Sold separately, each ticket would include a mark-up to cover costs that does not take account of the impact on the other airlines profit. Sold as a single ticket this double mark-up is eliminated.
241. The Proposed Conduct is also likely to facilitate the addition of new frequencies and destinations by the Applicants, or the addition of these frequencies and destinations sooner than would otherwise be the case.
242. By increasing the attractiveness of China Eastern’s Shanghai hub for connecting services between Australia and mainland China the Proposed Conduct will facilitate the Applicants proposed gateway strategy into greater China. However, the ACCC has not placed great weight on this as a separate public benefit resulting from the Proposed Conduct because regard has already been had to it in the ACCC consideration of the specific public benefit arguments about increased connectivity and expanded frequencies and destinations. Nor has the ACCC placed weight on the argument that this will result in a public benefit by triggering a competitive response from rivals. The ACCC considers that rival airlines will continue to strongly compete for passengers transferring into greater China with or without the alliance in place.
243. Further, the Applicants have proposed to add significant additional capacity over the first two years of the authorisation. However, the ACCC considers that substantiation of their public benefit claims would require significant additional growth in capacity over the remaining three years of the authorisation. Were this not the case, in considering any application for re-authorisation it may be difficult for the ACCC to accept the public benefit arguments that the proposed alliance facilitates the addition of new frequencies and destinations and the development of Shanghai as a gateway to greater China for Qantas and China Eastern.
244. The ACCC considers that the Proposed Conduct would also be likely to result in some public benefits through:
 - potentially enhancing the attractiveness of the Applicants’ loyalty programs and
 - cost savings resulting from terminal co-location in Shanghai which allows for more efficient management of transiting passengers and streamlining of processes for handling freight being transported to Shanghai by Qantas and onwards by China Eastern.

245. The ACCC also recognises that the Proposed Conduct has the potential to result in some public benefit in the form of promotion of tourism and trade between Australia and China. However, given the wide range of other factors which are likely to be more significant determinants of tourism and trade, the ACCC does not consider that the impact of the Proposed Conduct on tourism and trade is likely to be significant..

Public detriment

246. The CCA does not define what constitutes a public detriment and the ACCC considers its meaning as essentially the opposite of public benefit. In this regard the Tribunal has defined it as:

...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principle elements the achievement of the goal of economic efficiency.³⁰

247. As noted, the Applicants own metal services only overlap on one route, Sydney – Shanghai. Accordingly, in assessing the likely public detriments of the Proposed Conduct the ACCC has focused primarily on this route and the potential competitive harm resulting from Qantas and China Eastern coordinating their price and service decisions on this route (unilateral effects). On this route the ACCC considers that the competitive constraint Qantas and China Eastern impose on each other as the major carriers on this route is likely to be lost if the Proposed Conduct proceeds.

248. The analysis below also briefly considers whether the Proposed Conduct may increase the risk of coordinated conduct between the Applicants and other airlines operating services between China and Australia and the potential impact of the Proposed Conduct on competition in the other areas of competition outlined at paragraph 102.

249. The ACCC does not consider that the Proposed Conduct will have a significant impact on competition in any area of competition other than air passenger services on the Sydney-Shanghai route.

250. The ACCC's assessment of the likely public detriments from the Proposed Conduct follows.

The Sydney – Shanghai route – unilateral effects

251. The terms of the Coordination Agreement are not 'metal neutral.' Rather, each airline will retain an incentive to sell tickets on flights operated using its own aircraft over flights operated using its partner's aircraft. Therefore, there will remain some incentive for Qantas and China Eastern to compete with each other in the supply of air passenger services on the Sydney – Shanghai route. However, the proposed alliance gives Qantas and China Eastern the ability to coordinate their price and service decisions on the Sydney – Shanghai route.

252. There are two ways in which airlines or alliances may raise prices. The first is to raise airfares without varying capacity. This is not ideal as it is likely to mean the alliance will operate with lower load factors. Further, if there is excess capacity

³⁰ *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

available to rival airlines, there is a lesser likelihood that an alliance could profitably increase fares unless they were to reduce or limit growth in capacity due to the commercial imperative for airlines to fill empty seats.

253. The second is to reduce capacity (or to not grow capacity as quickly as would otherwise be the case). To the extent this makes seats on the route more scarce, airfares will likely rise.
254. In assessing the likelihood that an alliance would find it profitable to unilaterally reduce or limit growth in capacity, the ACCC has considered:
- the alliance's share of capacity (number of seats) and passengers
 - whether the services of the alliance partners are close substitutes
 - the competitive constraint imposed by other airlines and
 - the likelihood of timely entry or expansion on the route if the alliance attempted to reduce or limit growth in capacity (in order to raise airfares).
255. In response to the draft determination the Applicants also provided submissions about their incentives under the Proposed Conduct to increase or decrease capacity on the Sydney – Shanghai route. This issue is also considered below.

The alliance's share of capacity and passengers

256. The shares of capacity on the Sydney – Shanghai route (direct only) are shown on the graph at paragraph 53. The graph illustrates that Qantas and China Eastern had a combined share of capacity on the Sydney – Shanghai route of 84.5% (direct flights) for the year ending March 2015. This compares with a combined share of capacity flown of 78.5% in the year ending March 2014. Over the same period Air China's share of capacity has fallen from 21.5% to 15.5%.
257. Numerous airlines provide indirect flights between Sydney and Shanghai. The MIDT data at paragraph 57 provides an estimate that, inclusive of indirect flights, Qantas and China Eastern have a combined share of passengers flown between Sydney and Shanghai of 74%.³¹
258. The ACCC considers that the alliance's share of capacity on the route is such that, subject to consideration of the competitive constraint imposed by other airlines and the likelihood of timely entry or expansion, it may be profitable for the alliance to unilaterally reduce or limit growth in capacity to raise airfares.

Substitutability of Qantas and China Eastern services

259. The Applicants argued that the Proposed Conduct will bring together two complementary networks and business models. The Applicants argued that doing so will result in limited competitive detriment, primarily because operational overlap between the Applicants is limited to one route, Sydney – Shanghai.

³¹ Qantas has raised concerns with these estimates as discussed at paragraph 57 to 65.

260. The ACCC considers that operational overlap between the Applicants in relation to the majority of their networks, and the associated potential for coordination between the Applicants to generate significant competitive detriment, is limited. However, on the Sydney – Shanghai route, which accounts for around 23% of all passenger traffic between Australia and China (direct flights), the ACCC considers that Qantas and China Eastern are each other's closest competitors and the potential competitive detriment generated by the Proposed Conduct is significant.
261. Historically, Qantas passenger traffic has generally had a higher proportion of business passengers and oneworld alliance passengers than China Eastern; whereas China Eastern has had a greater proportion of Chinese based leisure travellers.
262. The purpose of travel data provided by BITRE shows that Qantas had a significantly higher proportion of passengers traveling for business than China Eastern (16% versus 6.5% for the year ending March 2015) but each had a similar percentage traveling for holidays (Qantas had 45.5% and China Eastern 46%). ABS data provided by Qantas estimated that between May 2009 and April 2014 Qantas and China Eastern each had a 15% share of leisure travellers between Australia and China but Qantas had a 21% share of business travellers compared to China Eastern's 9%.
263. However, notwithstanding that Qantas and China Eastern have, to some extent, different customer mixes, they offer similar services in many respects on the Sydney – Shanghai route. Both are full service airlines offering the same classes of travel. Departure times of their existing daily flights from Sydney to Shanghai and Shanghai to Sydney are closely aligned and both fly similar types of aircraft.
264. The ACCC considers that Qantas and China Eastern are each other's closest competitors on the Sydney – Shanghai route. They are the only two airlines that fly daily direct flights on the route and each has a share of capacity of over 40% (as measured on an annual basis). While Air China also provides direct flights between Sydney and Shanghai, it does not provide daily services and its share of capacity on the route is now only 15.5% (as measured on an annual basis). Air China has been reducing capacity on the route while Qantas and China Eastern have been increasing capacity.
265. Having regard to all available information, on balance the ACCC considers that Qantas and China Eastern are each other's closest competitors on the route. Some passengers may have a preference for one airline over the other but a considerable group of passengers are likely to be prepared to fly with either based on price. It is this competition between Qantas and China Eastern for these customers (which will benefit all customers through lower fares) that is likely to be lost if the Proposed Conduct proceeds.

Competitive constraint imposed by other airlines

266. Qantas submitted that Qantas and China Eastern will not have any ability or incentive to increase fares on the Sydney – Shanghai route as any attempt to do so is highly likely to result in an immediate and sustained decline in passenger numbers as customers switch to other carriers. They submitted that the focus on hub competition for carriers offering indirect services on the route will impose a competitive constraint.

267. The ACCC notes that the proposed alliance will reduce the number of independently determined direct flight price/service offerings on the Sydney – Shanghai route from three to two. The only other airline operating direct services on the route is Air China which offers direct services three days a week and, as noted, had a 15.5% share of capacity on the route for the year ended March 2015. This share has fallen from 21.5% for the year ended March 2010. Similarly, Air China's total capacity on the route has fallen by 31% over the same period, while China Eastern and Qantas' capacity have increased by 24% and 6% respectively. For these reasons Air China, does not appear to be as close a competitor to Qantas and China Eastern on the route as they are to each other.
268. Qantas submitted that it expects Air China to take advantage of the recently expanded capacity entitlements for Chinese carriers to increase frequencies on the Sydney – Shanghai route. However, no evidence in support of this claim was provided, beyond details of recently announced capacity increases by Air China on other routes.
269. In response to the draft determination Air China also submitted that it has the ability to increase capacity on the Sydney – Shanghai route and would also have the incentive to do so in response to any increase in fares or reduction in capacity that resulted from Qantas and China Eastern coordinating their operations on the route. Air China stated that it would have no incentive to engage in any sort of collusion (even tacit) with Qantas and China Eastern.
270. The ACCC considers that it is unlikely that Air China, the only other airline to operate direct flights on the route, with significantly fewer frequencies and declining capacity (on a route which is growing), will provide a sufficient constraint to Qantas and China Eastern in the event that they decided to reduce or limit growth in capacity and/or increase airfares. Given its existing capacity on the route, any increase in capacity by Air China would have to be significant to constrain Qantas and China Eastern. The ACCC considers that any competitive response by Air China is unlikely to be sufficient to make a unilateral reduction or limitation in growth of capacity and/or increase in airfares unprofitable for Qantas and China Eastern. Further, notwithstanding its submission to the contrary, it may be in Air China's interest to raise its airfares to some extent in response to any increase in price/reduced capacity by Qantas and China Eastern.
271. Given the potential limits of the competitive constraint imposed by Air China, in assessing the impact on competition of the Proposed Conduct on the Sydney – Shanghai route, the ACCC has also considered the extent of substitutability of indirect flights and/or flights to other destinations in China.
272. The Applicants argued that other airlines operating between Australia and China will act as an effective competitive constraint. Qantas also provided confidential data about the growth in the number of passengers flying between Australia and China on indirect routes in support of their argument about the competitive constraint imposed by indirect flights. However, the data provided by Qantas indicates that indirect traffic is growing at a slower rate than direct traffic (i.e. indirect traffic as a share of all traffic is falling).
273. Qantas also provided confidential examples of the monitoring it, and China Eastern, undertakes of the prices offered by other airlines, for both direct and indirect flights on the Sydney – Shanghai route and other routes between Australia and China. In a submission in response to the draft determination

Qantas also provided examples of a number of instances where it submits that it has reduced fares on the Sydney – Shanghai route in response to fares offered by indirect carriers.

274. These examples do appear to indicate that Qantas has regard to indirect flights when setting prices on the Sydney – Shanghai route. However, details about the context in which relevant pricing decisions were made by Qantas was not provided.
275. The ACCC does not consider that airlines offering indirect flights between Sydney and Shanghai, or travel on alternative routes between Australia and China, will impose as significant a competitive constraint on the Applicants as direct flights on the route would.
276. The ACCC notes that, as discussed at paragraph 108, as a generalisation, leisure travellers are relatively more price sensitive and relatively less concerned about other factors such as travel time compared to business travellers. The more price sensitive, and less time sensitive a passenger, the more likely they are to consider indirect flights between Sydney and Shanghai, such as with Cathay Pacific through its Hong Kong hub; Singapore Airlines through its Singapore hub; and China Southern through its Guangzhou hub, to be substitutes for the services of the Applicants.
277. Qantas, China Eastern and Air China direct flights between Sydney and Shanghai are between 10:20 and 10:55 hours in duration. Indirect flights vary significantly by airline with the shortest durations being Cathay Pacific flights via Hong Kong (12:35 to 13:10). On price, Cathay Pacific and China Southern are comparable to, and on occasions significantly cheaper than, direct flights offered by the Applicants.
278. However, notwithstanding this, the MIDT data suggests that indirect flights account for only around 12% to 15% of all travel between Sydney and Shanghai. Cathay Pacific has the largest share among airlines providing indirect flights (7% based on MIDT data) while the combined market share of Qantas and China Eastern, inclusive of indirect flights, is 74% (based on MIDT data).
279. The ACCC accepts that the Applicants actively monitor, and at times respond to, the pricing decisions of all airlines operating both direct and indirect flights on the Sydney – Shanghai route. The ACCC considers that each of these airlines competes to some degree with Qantas and China Eastern on this route. However, the relevant question for the ACCC to consider in the context of the Proposed Conduct is the degree of the competitive constraint that other airlines are likely to place on the product and service offerings of the Applicants if the Proposed Conduct does proceed.
280. The ACCC considers that, for the reasons outlined above, indirect flights are a significantly weaker competitive constraint on Qantas and China Eastern than Qantas and China Eastern are on each other.
281. In response to the draft determination the Applicants also provided a report prepared for them by Houston Kemp which argued that the proportion of passengers travelling between Sydney and Shanghai on indirect services is greater than 10%, which is the market share at which the ACCC considers

imports to impose a competitive constraint in the context of merger reviews. However, this argument misrepresents the ACCC's Merger Guidelines.

282. The ACCC's Merger Guidelines state that imports are *most likely* to provide an effective and direct constraint when a number of conditions listed in the guidelines are *all* met. One of these conditions is that independent imports represent at least 10% of total sales in each of the last three years. Other conditions include that imported product is a strong substitute in all respects (that is, quality, range, price etc.) for the relevant product of the merged firm.³² As discussed above, the ACCC does not consider that indirect flights are a strong substitute in all respects for direct flights offered by Qantas and China Eastern.
283. The Houston Kemp report also argued that the gross margin on sales of long haul flights is likely to be very high, suggesting that the critical loss of sales that would make a small but significant and non-transitory increase in price (**SSNIP**) on direct services on these flights unprofitable is likely to be relatively low. The implication being if Qantas and China Eastern were to raise prices passengers would switch to other carriers. In particular, Houston Kemp noted that in three of four departure dates it examined between late April and early July 2015, Qantas flights were approximately \$200 to \$250 more expensive than indirect flights operated by Cathay Pacific. Houston Kemp argued that a 5% SSNIP (\$50 fare increase) by Qantas would encourage at least some customers to switch from the direct to indirect services.
284. However, the ACCC notes that in undertaking such analysis it is important to consider what the 'actual loss' from an increase in price would be. Houston Kemp provided no analysis about this.
285. Another important consideration that Houston Kemp did not address is the extent to which lost sales from an increase in price would be diverted to the other alliance partner. In this case the ACCC has concluded that Qantas and China Eastern are each other's closest competitor. They are two of only three carriers operating direct flights and the only carriers operating daily direct flights. It could therefore be expected that a significant proportion of any margin lost from reduced sales as a result of a price increase by one alliance partner would be picked up by the other alliance partner.
286. More generally, as noted above, the market share of indirect carriers on the Sydney – Shanghai route is currently only around 12% to 15 % despite them on occasions being significantly cheaper than direct flights offered by the Applicants.
287. Houston Kemp also argued that indirect operators have a strong incentive to attract Sydney – Shanghai traffic to supplement their direct point to point traffic and reduce their average costs. The ACCC agrees with this assertion. However, this assertion does not address the fundamental reason for the ACCC's conclusion that indirect services are a significantly weaker competitive constraint on Qantas and China Eastern than they are on each other — travellers' preference for direct flights — and the available evidence indicating that this preference is reflected in the low market shares of indirect carriers on the route.
288. Another relevant factor in considering the competitive constraint imposed on Qantas and China Eastern by other airlines is the extent of 'beyond travel' by

³² ACCC Merger Guidelines, November 2008, p 41.

passengers on the Sydney – Shanghai route. That is, passengers flying the Sydney – Shanghai route whose ultimate origin and/or destination is a point in China or Australia other than Sydney or Shanghai. These passengers are more likely to regard services provided by other airlines transiting through cities, or ‘hubs’ other than Shanghai or Sydney as substitutable for the Sydney – Shanghai service provided by the Applicants.

289. In this respect, the Applicants argued that there is intense competition between hubs to attract passengers transferring into greater China. The Applicants also argued that the ACCC has previously recognised the nature of hub competition and the ability of hubs to provide constraints on coordinated conduct and cite examples of this from previous ACCC decisions in relation to applications for authorisation of airline alliances. However, the ACCC notes that the examples cited primarily relate to analysis of competition on routes that do not have the option of direct flights (e.g. Australia – Europe).
290. The ACCC notes that, at least in respect of Qantas passengers traveling to Shanghai, data supplied by Qantas shows that less than 3% of Qantas ticketed passengers transferred to a China Eastern flight to travel to another destination in China following arrival in Shanghai. Information provided by China Eastern indicates that a significantly higher proportion of China Eastern passengers traveling to Shanghai transferred to another China Eastern flight for onward travel.
291. Qantas argues that the low level of transfers by Qantas ticketed passengers to onward China Eastern flights from Shanghai is due to the issues with connectivity between the airlines due to them operating out of different terminals. As discussed in relation to public benefits, Qantas argues that the Proposed Conduct will help to address these concerns such that more passengers will be willing to pursue onward travel with China Eastern following arrival in Shanghai.
292. As discussed at paragraph 205, the ACCC considers that there is strong competition between airlines operating out of hubs within and outside of China for the many passengers traveling between Australia and points in China not serviced by direct flights. The ACCC does not consider that the Proposed Conduct will adversely impact competition between airlines for these passengers.
293. However, the data provided by Qantas suggests that, at least for Qantas ticketed passengers, Sydney – Shanghai is currently a strong ‘point to point’ route such that other hubs that passengers are able to utilise to travel to points in China other than Shanghai are unlikely to be a strong competitive constraint. While the Proposed Conduct will likely improve the Applicants’ ability to attract passengers traveling into greater China through China Eastern’s Shanghai hub, the route will also remain a strong point to point route.
294. The ACCC also notes that some passengers on the Sydney – Shanghai route, particularly leisure travellers, may wish to visit a number of parts of China, including Shanghai, but may be indifferent about their entry and exit point from China. The same may be true of some Chinese passengers traveling to Sydney. The passenger purpose of travel data provided by BITRE indicates that, for passengers traveling between Australia and China in 2014 (inclusive of inbound and outbound traffic) 46% indicated holiday as their reason for travel. A proportion of these travellers may be indifferent between Shanghai and other entry points to China (or Sydney and other entry points to Australia). The remaining 54% of

travellers who indicated a reason for travel had destination specific reasons for travel (business, visiting family and friends, education etc.).

295. Competition from airlines transiting through cities other than Sydney and Shanghai would not impose a competitive constraint on the Applicants in respect of the provision of services to passengers traveling between Sydney and Shanghai as a point to point route.
296. In summary, while the widespread availability of indirect flights is likely to limit to some degree the extent to which Qantas and China Eastern could reduce or limit capacity growth to raise their airfares, indirect flight are likely to be a significantly weaker competitive constraint than Qantas and China Eastern are to each other on flights between Sydney and Shanghai, for point to point passengers.
297. The Applicants argued, primarily by reference to the Houston Kemp report, that the Proposed Conduct will provide incentives for China Eastern to expand, rather than limit capacity growth. This is because the terms of the Joint Coordination Agreement have the effect that Qantas subsidises and supports China Eastern operations which de-risks their expansion plans.
298. As discussed at paragraph 192 the ACCC considers that the financial payment terms of the Joint Coordination Agreement lessens the commercial risk to China Eastern in undertaking capacity expansion.
299. However, while the Proposed Conduct reduces the risk to China Eastern in undertaking any expansion, this does not change any incentives or ability China Eastern and Qantas will have to unilaterally reduce capacity, or limit growth in capacity, to increase airfares on the Sydney – Shanghai route. That is, reducing the risk to China Eastern in undertaking expansion would not in itself incentivise expansion if the Applicants considered that limiting capacity growth was likely to be a more profitable strategy.
300. In this respect, Houston Kemp argued that the Proposed Conduct would only provide the Applicants with an increased ability and/or incentive to unilaterally reduce or limit capacity growth if this was a profit maximising strategy and:
 - the Proposed Conduct provided one or both parties with an enhanced ability to influence the capacity decisions of the other, and/or
 - the contemplated information sharing provided the parties with a greater assurance that a reduction in, or limitation in the growth of, capacity would not be countered by an offsetting increase by the other party.
301. In essence, Houston Kemp is arguing that allowing Qantas and China Eastern to come together and discuss their operations, including discussing coordinating their activities, in and of itself would not raise the risk of them reaching an agreement about how they each allocate capacity because neither has a mechanism by which they can explicitly force the other to honour the agreement. The ACCC notes that by this rationale, short of a binding contractual arrangement, no agreement between competitors in relation to, for example, prices or market sharing, would ever be able to be successfully implemented.
302. In this respect, the ACCC's concern is not that that Qantas and China Eastern would be able to make decisions about the capacity the other airline allocates.

Rather, the ACCC's concern is that the alliance provides a forum for the Applicants to collectively agree on the capacity each will individually allocate. The ACCC also notes that the Applicants have explicitly sought authorisation to coordinate their activities and operations, including in relation to frequencies.

303. The ACCC does note that decisions by the Applicants about the capacity to allocate to routes between Australia and Shanghai will have regard to servicing both point to point and transferring passengers. With respect to passengers travelling into greater China, competition from other hubs means that limiting capacity to increase airfares (for these passengers) is unlikely to be a profitable strategy. Therefore any consideration of limiting capacity to increase airfares for point to point passengers would involve a trade off with the likely loss of transferring passengers to airlines operating through other hubs. While, at present, Sydney – Shanghai point to point passengers make up the majority of passengers on the route, this is likely to mitigate, to some extent, incentives for the Applicants to limit capacity to increase airfares for Sydney – Shanghai point to point passengers.
304. However, notwithstanding this, the limited competitive constraint on the Applicants in relation to point to point passengers is also likely to provide them with the incentive and ability to raise fares on the Sydney – Shanghai point to point route. That is, while fares will be set by the Applicants for travellers whose final destination is a point in greater China beyond Shanghai having regard to the numerous other hubs through which the passenger could transfer to reach their destination, as discussed above, the competitive constraint on the Applicants in setting fares on the Sydney – Shanghai point to point route is far more limited.
305. The ACCC notes that this type of pricing strategy, whereby an airline charges higher fares for passenger on a point to point route where competition is limited than for passengers travel on the same flight who have an onward connection to a destination that is serviced by a variety of carriers, is not uncommon in the airline industry. For example, the ACCC notes that Qantas often charges higher fares between Sydney and Dubai, where the only other carrier operating direct flights is Qantas' alliance partner (Emirates), than for travel on the same plane continuing on to London, where Qantas faces competition from numerous other carriers operating through hubs other than Dubai.
306. All else being equal, the ACCC considers that the Applicants would be likely to adopt similar pricing strategies on the Sydney – Shanghai route if the opportunity to do so arose.
307. As discussed below, the conditions of authorisation imposed by the ACCC will require the Applicants to report their average fares by cabin class on a route by route basis. Therefore, if the Applicants do charge higher prices for passengers travelling on the Sydney – Shanghai point to point route than they do for passengers transferring through Shanghai to other destinations where the Applicants face greater competition from other hubs, this will be apparent in this reporting. If Qantas and/or China Eastern did raise their prices on the Sydney – Shanghai route, relative to other routes between Australia and China, this would be likely to generate a significant public detriment which would be relevant to the ACCC's assessment of the public benefits and detriments likely to result from the alliance in considering any application for re-authorisation.

Likelihood of timely entry and expansion

308. The Applicants argued that barriers to entry and expansion are low and that, in particular, expansion by Chinese carriers, particularly China Southern and Sichuan Airlines, in response to the Proposed Conduct is expected.
309. Qantas further submitted that increases in capacity entitlements under the Air Services Agreement will lead to growth between Australia and existing major gateways in China and emerging gateways in China. Qantas also noted examples of recent capacity additions (increased frequencies and new routes) by Chinese airlines. Qantas submitted that all of these new and expanding operations will constrain the Applicants in respect of Sydney – Shanghai servicing and pricing.
310. The ACCC notes that none of the examples cited by Qantas were on the Sydney – Shanghai route. The ACCC does not consider that airlines operating on other routes will impose a significant competitive constraint on services offered by Qantas and China Eastern on the Sydney – Shanghai route.
311. The ACCC considers that, while demand for air services in China has grown rapidly over the last five years and significant growth (both from new frequencies and new routes) can be expected to continue in the short to medium term, timely entry or expansion on the Sydney – Shanghai route on a scale sufficient to provide a competitive constraint is unlikely.
312. In Australia, Virgin has stated its preference is to expand its international network in Asia through strategic alliances with existing carriers. In considering the proposed alliance between Virgin and Singapore Airlines, the ACCC concluded that absent the alliance Virgin would be unlikely to commence standalone services to destinations serviced by Singapore Airlines.
313. There are a number of Chinese airlines with extensive international networks, including routes to Australia, who do not currently operate on the Sydney – Shanghai route. Most notably, China Southern and Sichuan Airlines. However, none of these airlines, or any other Chinese airlines, currently operate direct longhaul flights to any destinations from Shanghai Pudong or Shanghai Hongqiao airports.
314. As with most international airlines, Chinese airlines base their international operations around their home hubs. For example, other than China Eastern Beijing to Sydney (via Nanjing) flights, all China Southern, China Eastern, Air China and Sichuan Airlines direct flights to destinations in Australia originate from their home hubs. China Eastern and Air China are the only airlines flying international longhaul flights with hubs in Shanghai.
315. While a number of new smaller airlines have recently or are planning to commence operations from China, the ACCC is not aware of any who will have bases in Shanghai and plan to offer longhaul services. Nor were the Applicants able to provide examples of any. Further, in relation to services between Australia and China, Sydney – Shanghai is not growing as strongly as other, less mature routes, and as such greater opportunities for airlines looking to enter or expand exist on alternative routes.
316. Therefore, the ACCC considers that it is unlikely that another Chinese carrier will commence operating direct flights on the Sydney – Shanghai route in the short to

medium term generally, or in response to an increase in airfares or reduction in service levels by the Applicants.

The Sydney-Shanghai route – coordinated effects

317. In considering other aviation alliances the ACCC has also considered whether the alliance could increase the risk of coordinated conduct between the Applicants and other carriers operating services on relevant routes. For example, the high level of concentration on the Sydney – Shanghai route arguably creates a strong incentive for the Applicants and Air China to coordinate their conduct on this route, for example, through a common strategy to limit growth in capacity.
318. As discussed above, the ACCC considers that the Proposed Conduct is likely to provide Qantas and China Eastern with an increased ability and incentive to unilaterally reduce capacity, or limit growth in capacity, to increase airfares on the Sydney – Shanghai route, with little constraint from Air China.
319. Given this conclusion about the unilateral effects of the Proposed Conduct, the ACCC has not undertaken a detailed consideration of potential coordinated effects in assessing the Proposed Conduct. Any increased ability to coordinate with Air China would only enhance the anti-competitive detriment of the Proposed Conduct.

ACCC conclusion on public detriment on the Sydney – Shanghai route

320. The ACCC considers that Qantas and China Eastern are each other's closest competitor on the Sydney – Shanghai route. They had a combined share of capacity on the route of 84.5% over the 12-month period from April 2014 to March 2015 (direct flights). The only other airline offering direct services on the route, Air China, has a more limited service offering and has been reducing capacity on the route over the last five years while Qantas and China Eastern have been growing capacity.
321. The ACCC considers that Air China – and especially indirect services provided by other airlines – are likely to be significantly weaker competitive constraints on Qantas and China Eastern on this route, and that timely new entry and/or expansion is unlikely.
322. The Proposed Conduct will likely improve the Applicants' ability to attract passengers travelling into greater China through China Eastern's Shanghai hub. However, Sydney – Shanghai is also likely to remain a strong point to point route. Competition from other airlines for passengers transiting through Shanghai to other destinations will not impose a competitive constraint on the Applicants in providing services to passengers travelling on the point to point route.
323. For these reasons, the ACCC considers that the Proposed Conduct is likely to result in significant public detriment by removing the competitive constraint that Qantas and China Eastern, as the major carriers on this route, impose on each other. In particular, the Proposed Conduct is likely to provide Qantas and China Eastern with an increased ability and incentive to raise prices for passengers on this route.

Other areas of competition potentially affected by the Proposed Conduct

Passenger services on routes other than Sydney – Shanghai

324. Qantas does not directly operate flights on any routes into or out of China other than Sydney – Shanghai. Based on the information provided by the Applicants, including confidential information provided by Qantas, the ACCC considers it unlikely that they would commence doing so over the timeframe for which authorisation is sought (5 years).
325. Qantas has also advised that they do not intend to make any changes to their existing interline and codeshare arrangements with other airlines providing services to and within China (Cathay Pacific and China Southern).
326. As noted at paragraph 41, Qantas currently codeshares on a hard block basis on China Eastern's Melbourne – Shanghai service and China Eastern codeshares on a hard block basis on Qantas' Sydney – Shanghai service. Under a hard block codeshare the marketing carrier has a block of seats to sell on the operating carrier's flight.
327. This means that the operating carrier and the codeshare partner each sell separate inventories of seats on the relevant flights and in doing so compete against each other to sell their inventories. Hard block arrangements can potentially be more competitive than freesale codeshare arrangements because their fixed cost characteristics can provide strong incentives for price competition.
328. Under the Proposed Conduct the Applicants will allow sales of each other's services on a freesale basis and will pay each other an upfront, monthly commission regardless of which carrier's code or ticket the passenger is travelling on. By selling in this way, each carrier will have access to every seat on the other carrier's flights which are operated between Australia and China. Under the Proposed Conduct the Applicants will also be able to coordinate their price and service decisions.
329. This means that the Applicants will no longer have the separate inventories of seats on each other's flights noted at paragraph 326 to sell. Further, the Applicants will be able to coordinate their decisions about fares charged by them on the route.
330. The ACCC considers that these changes to the arrangements between Qantas and China Eastern are likely to reduce competition between Qantas and China Eastern in respect of the seats that are the subject of the current hard block sale arrangements. However, having regard to confidential information provided by the Applicants about the existing hard block codeshare arrangements, the ACCC does not consider that the reduction in competition between the Applicants on the Melbourne – Shanghai route compared to the existing hard block codeshare is likely to be material.
331. The ACCC considers that it is unlikely that Qantas would be a strong competitor against China Eastern on any other route between Australia and China. Therefore the ACCC considers that the Proposed Conduct is unlikely to raise competition concerns on any other route.

International air cargo transport services (freight and mail) between Australia and China

332. No interested party commented on the effect of the Proposed Conduct on international air cargo transport services.
333. Freight and mail is carried in the holds of aircraft used for passenger services as well as by dedicated freighters. Between China and Australia this includes Qantas, Singapore Airlines, Cathay Pacific and Malaysian Airlines (holds of passenger services and dedicated freighters), China Eastern, China Southern and Air China (holds of passenger services only) and DHL, UPS and Federal Express (dedicated freighters). Further background about air cargo services between Australia and China is provided at paragraphs 67 to 71.
334. For the reasons discussed at paragraph 110, the ACCC has generally defined markets for air freight and air mail services more broadly than for passenger services as including indirect as well as direct services between points.
335. BITRE data indicates that shares of freight and mail between China and Australia varied significantly between 2010 and 2014. China Southern had the greatest share of both freight (35%) and mail (53%) in 2014. Qantas had a 20% share of freight and 22% share of mail while China Eastern had shares of 20% (freight) and 2% (mail).
336. Between Sydney and Shanghai BITRE data only records direct flights. Given that indirect flights are generally considered to be effective substitutes for direct flights in the delivery of mail and freight, as travel time and convenience are often not as valued as for passenger services, shares of mail and freight derived from these figures do not necessarily provide an accurate picture of competition between carriers on this route.
337. Given the greater competitive constraint provided by indirect flights, the ACCC consider that the Proposed Conduct is unlikely to raise the same competition concerns on the Sydney – Shanghai route as in relation to passenger services.

Balance of public benefit and detriment

338. In general, the ACCC may grant authorisation if it is satisfied that, in all the circumstances, the Proposed Conduct is likely to result in a public benefit, and that public benefit will outweigh any likely public detriment, including any lessening of competition.
339. The ACCC considers that the Proposed Conduct is likely to result in a range of public benefits.
340. The ACCC considers that there is a greater prospect of new frequencies, direct services and destinations in the future under the proposed alliance. In particular, the financial payment terms of the Joint Coordination Agreement lessens the commercial risk to China Eastern in undertaking capacity expansion. Further, the Applicants will be able to combine load volumes and the likely expansion of the codeshare routes will also promote greater traffic on routes between Australia and Shanghai and thereby contribute to underpinning the viability of expanding capacity.

341. However, the ACCC also notes that China Eastern has been steadily expanding capacity on routes between Shanghai and Australia in recent years without the Proposed Conduct and the proposed growth in frequencies that they have advised the ACCC about, when considered over the five year term of the authorisation sought, are broadly consistent with their historical capacity expansion.
342. All the capacity the Applicants propose to add will be added in the first two years if the alliance is authorised. The ACCC accepts that the Applicants may not wish to commit to further capacity additions beyond the first two years until closer to the time that further capacity may be added when they would have more certainty about market conditions and passenger demand.
343. However, notwithstanding this, having regard to trends in historical growth in capacity by them the ACCC considers that substantiation of the Applicants public benefit claims in relation to increased frequencies and destinations would require the addition of significantly greater additional capacity over the five year term of the authorisation than the Applicants currently propose to add over the first two years.
344. As noted, following the draft determination the Applicants also advised of a significant expansion in the range of destinations that they submit will be covered by their current codeshare agreement if their proposed alliance proceeds. The ACCC considers that the expansion in destinations covered by the alliance is likely to result in a number of public benefits. Passengers will have access to a greater range of online connections (itineraries of two or more flights where connections are made between flights of the same airline or its codeshare partners) removing the risk of forfeiting non-refundable funds if the first journey is delayed, increasing convenience in not having to collect and recheck baggage, saving time in through checking and reducing transit times.
345. Expanding the number of routes where journeys can be booked on a single ticket (rather than requiring tickets to be booked with both airlines) should also lead to lower prices for passengers utilising a connection in Australia or a connection in Shanghai that involves flights operated by both Qantas and China Eastern. If, absent coordination between the Applicants, these flights have to be booked separately, each airline will charge a price which includes a mark-up to cover their costs but does not take account of the impact on the other airlines profit (double marginalisation). By coordinating their pricing this 'double mark-up' is eliminated.
346. By enabling Qantas to co-locate at China Eastern's terminal in Shanghai the Proposed Conduct will also provide passengers on Qantas flights from Sydney to Shanghai with improved connectivity and convenience when transferring to a China Eastern flight for onward travel. However, passengers who value the convenience of not having to change terminals when transferring between flights are already able to fly with China Eastern directly, or in the case of some destinations, with other airlines that transit through hubs other than Shanghai. Therefore, the ACCC considers that while the improved connectivity and convenience resulting from terminal co-location is a public benefit it is likely to accrue only to customers who wish to transfer to a China Eastern flight in Shanghai for onward travel and who have a preference to fly with Qantas for the Sydney – Shanghai leg of their journey.

347. The Proposed conduct is also likely to enable better scheduling of complementary services by the Applicants, thereby facilitating greater connectivity between their services than under the existing codeshare agreement.
348. The ACCC also accepts that the Proposed Conduct will facilitate the Applicants proposed gateway strategy by increasing the attractiveness of China Eastern's Shanghai hub for connecting services between Australia and mainland China. In particular, the increased connectivity and convenience and increased frequencies likely to result from the Proposed Conduct will make flights transiting through Shanghai a more attractive proposition for some passengers travelling to points in China not serviced by direct flights. However, the ACCC has not placed great weight on this as a separate public benefit resulting from the Proposed Conduct because regard has already been had to it in the ACCC consideration of the specific public benefit arguments about increased connectivity and expanded frequencies and destinations. Nor has the ACCC placed weight on the related argument that this would result in a public benefit by triggering a competitive response from rivals. The ACCC considers that rival airlines will continue to strongly compete for passengers transferring into greater China with or without the alliance in place.
349. The ACCC also considers that the Proposed Conduct is likely to result in public benefits through enhancing the attractiveness of the Applicants' loyalty programs, and cost savings resulting from terminal co-location in Shanghai, which allows for more efficient management of transiting passengers and streamlining of processes for handling freight being transported to Shanghai by Qantas and onwards by China Eastern.
350. The ACCC also recognises that the Proposed Conduct has the potential to result in some public benefit in the form of the promotion of tourism and trade between Australia and China. However, given the wide range of other factors which are likely to be more significant determinants of tourism and trade the ACCC does not consider the impact of the Proposed Conduct on tourism and trade is likely to be significant.
351. The ACCC considers that operational overlap between the Applicants in relation to the majority of their networks, and the associated potential for coordination between them to generate significant competitive detriment, is limited. However, on the Sydney – Shanghai route the ACCC considers that Qantas and China Eastern are the major carriers and each other's closest competitors and the likely competitive detriment generated by the Proposed Conduct is significant.
352. In particular, Air China, as the only other airline offering direct flights on the route, but with significantly fewer frequencies than the Applicants and declining capacity on the route over the last five years (in contrast to the Applicants increasing their capacity on the route), is unlikely to sufficiently constrain Qantas and China Eastern if they decide to reduce or limit growth in capacity to increase air fares.
353. The ACCC also considers indirect services provided by other airlines are likely to be weaker competitive constraints on Qantas and China Eastern on this route than they are on each other. MIDT data suggests that indirect flights account for only around 12% to 15% of all travel between Sydney and Shanghai despite being priced comparably to, and on occasion significantly cheaper than, direct flights offered by the Applicants.

354. The ACCC also considers that, while demand for air services in China has grown rapidly over the last five years and significant growth, both from new frequencies and new routes, can be expected to continue in the short to medium term, timely entry or expansion on the Sydney – Shanghai route on a scale sufficient to provide a competitive constraint is unlikely. China Eastern and Air China are the only airlines flying international longhaul flights with hubs in Shanghai and the ACCC is not aware of any other airlines with plans to establish bases in Shanghai and offer longhaul services.
355. The Proposed Conduct is likely to improve the ability for Qantas and China Eastern’s to attract passengers traveling into greater China through China Eastern’s Shanghai hub. In this respect, decisions by the Applicants about the capacity to allocate to routes between Australia and Shanghai will have regard to servicing both point to point and transferring passengers. With respect to passengers travelling into greater China, competition from other hubs means that limiting capacity to increase airfares (for these passengers) is unlikely to be a profitable strategy. Therefore any consideration of limiting capacity to increase airfares for point to point passengers would involve a trade off with the likely loss of transferring passengers to airlines operating through other hubs. This is likely to mitigate, to some extent, incentives for the Applicants to limit capacity as a means of increasing airfares for Sydney – Shanghai point to point passengers.
356. However, even if the Applicants decisions about allocating capacity on routes between Australia and China are ultimately primarily driven by endeavouring to capture more passengers traveling to destinations in greater China, the limited competition from other airlines on the Sydney – Shanghai route means the Proposed Conduct will provide them with the ability and incentive to increase prices for passengers traveling directly between these two cities. While fares will be set by the Applicants for travellers whose final destination is a point in greater China beyond Shanghai having regard to the numerous other hubs through which the passenger could transfer to reach their destination, as discussed above, the competitive constraint on the Applicants in setting fares on the Sydney – Shanghai point to point route is far more limited.
357. For these reasons, the ACCC considers that the Proposed Conduct is likely to result in significant public detriment by removing the competitive constraint that Qantas and China Eastern, as the major carriers on the Sydney - Shanghai route, impose on each other. In particular, the Proposed Conduct is likely to provide Qantas and China Eastern with an increased ability and incentive to raise prices for passengers on this route.
358. On balance, the ACCC considers that subject to the conditions outlined below the Proposed Conduct is likely to result in public benefits that would outweigh the detriment to the public constituted by any lessening of competition that would result or would be likely to result from the proposed conduct.
359. However, having regard to:
- the Applicants argument that the alliance will facilitate significant expansion of frequencies and destinations and improve their ability to compete, through China Eastern’s Shanghai hub, with other airlines for passengers travelling into greater China

- the capacity additions the Applicants are currently prepared to commit to, when considered over the five year term of the authorisation sought reflecting expansion that is broadly consistent with their historical growth on relevant routes, and
- the Applicants argument that the capacity additions they are prepared to commit to can be used to test the market and that the services will be further extended to year round if demand is sufficiently stimulated

the ACCC would expect to see evidence of these public benefits being realised in the form of significant capacity expansion and significant increases in passengers traveling through China Eastern's Shanghai hub into greater China over the term of the authorisation. If this were not the case it may be difficult for the ACCC to accept these public benefit arguments in considering any application for re-authorisation.

Conditions of authorisation

360. The CCA permits the ACCC to grant authorisation subject to conditions.³³ While there is no express limit on the types of conditions which may be imposed on the grant of an authorisation, the power to impose conditions is constrained by the subject matter, scope and purpose of the CCA.³⁴
361. While the CCA does not expressly limit the circumstances when the ACCC may impose conditions, circumstances in which the ACCC may consider imposing conditions include where there is no or insufficient public benefit and imposing a condition may increase the benefit or reduce the detriment, thereby generating a sufficient net public benefit.³⁵
362. The Applicants stated that they do not consider a condition of authorisation is necessary. However, the address the ACCC's concerns they proposed a draft capacity condition.
363. The ACCC considers that a capacity commitment can, if appropriately set, limit the identified competitive harm on the Sydney – Shanghai route by limiting the ability of the Applicants to unilaterally reduce or limit growth in capacity. On the other hand, the ACCC is conscious that a capacity commitment may have the effect of deterring entry onto the relevant routes or result in the inefficient allocation of capacity.

³³ Section 91(3)

³⁴ See *Re Medicines Australia Inc* [2007] ACompT 4 at [129].

³⁵ See *Re Medicines Australia Inc* [2007] ACompT 4 at [123].

364. The ACCC considered two options for the structure of a capacity commitment in this matter:
- to cover the total capacity on all routes between Shanghai and Australia, or
 - to cover the individual capacity on the route where the ACCC has raised competition concerns, being the one route on which the Applicants both operate flights, Sydney – Shanghai.
365. Setting a capacity commitment covering total capacity on all routes between Shanghai and Australia has the benefit of providing the Applicants with the most amount of flexibility to respond to changing market circumstances. Setting a capacity commitment across all relevant routes also provides greater certainty that some of the public benefits from the Applicants adding additional frequencies and destinations will be realised.
366. However, including all routes between Shanghai and Australia in the capacity undertaking is likely to provide Qantas and China Eastern with greater scope to exercise market power on the route of concern. In particular, the Applicants may be able to meet a capacity commitment applied in aggregate across all routes while still limiting capacity on the Sydney – Shanghai route.
367. Setting a capacity commitment specifically on the Sydney – Shanghai route directly targets the route of concern, and provides the most effective limit on the identified competitive harm. However it provides the Applicants with the least flexibility to move capacity in response to changes in market conditions.
368. The ACCC has developed the conditions using a combination of these two options. The conditions in full are at **Attachment B**.
369. The key features of the conditions are:
- The Applicants are required to maintain at least their current level of capacity, in aggregate, across all routes between Australia and Shanghai during each scheduling season over the term of the authorisation (five years).
 - The Applicants are required to increase their capacity on routes between Shanghai and Australia over the term of the authorisation by a compound annual growth rate (CAGR) of 4%. To achieve the CAGR the Applicants will have to increase their capacity of routes between Australia and Shanghai by around 21.67% over the next five years.
 - The Applicants are required to maintain at least their current level of capacity on the Sydney – Shanghai route during each scheduling season over the term of the authorisation.
 - The Applicants are not, in the first instance, required to add capacity specifically on the Sydney – Shanghai route. However, the ACCC is able to review, and require that a CAGR be applied specifically to the Sydney – Shanghai route, over the term of the authorisation. Any capacity the ACCC did require the Applicants to add on this route would also count towards

meeting their obligation to increase capacity on routes between Australia and Shanghai.

370. The ACCC has set the CAGR to apply in aggregate across all routes between Shanghai and Australia at 4% having regard to the Applicants historical growth on relevant routes and their planned capacity expansions over the term of the authorisation. Specifically, a CAGR set at this level broadly accords with the rate at which the Applicants have added capacity on relevant routes in recent years. It also accords with the rate of growth the Applicants will achieve if they add all the capacity that they have stated that they will if authorisation is granted. In this respect, requiring the Applicants to add this capacity ensures that the Proposed Conduct does not result in a reduction in the frequency of services provided below that which could be expected if the alliance was not in place and Qantas and China Eastern continued to compete strongly with each other for passengers.
371. The ACCC has also had regard to the five year term of the authorisation sought. The ACCC accepts that decision about adding additional capacity beyond that currently proposed will be driven by market conditions and passenger demand, including the impact of the initially proposed capacity additions on passenger demand. The ACCC accepts that the Applicants do not wish to commit to further capacity additions until there is greater commercial certainty about the viability of adding further capacity. Accordingly, the ACCC has set the CAGR at 4%
372. However, all else being equal, the ACCC expects that successful implementation of the gateway strategy underpinning the Applicants' public benefit arguments should result in significant additional growth in capacity above that required by the conditions. If this were not the case, it may be difficult for the ACCC to accept that the alliance facilitates the addition of new frequencies and destinations and the development of Shanghai as a gateway to greater China for Qantas and China Eastern in any application for re-authorisation.
373. The ACCC has decided not to require the Applicants to add capacity specifically on the Sydney – Shanghai route at this time. As noted, a route specific capacity undertaking, provides the Applicants with the least flexibility to move capacity in response to changes in market conditions. In this respect, the ACCC is particularly conscious of China Eastern's intention to introduce a new route between an Australian destination and Shanghai and increase capacity on the Melbourne – Shanghai route by a significantly greater amount than on the Sydney – Shanghai route (reflecting that currently China Eastern offers fewer services on the Melbourne – Shanghai than Sydney – Shanghai route).
374. Further, the ACCC notes that Sydney – Shanghai is a more mature route than other routes flown by the Applicants between Shanghai and Australia. Requiring the Applicants to specifically grow capacity on this route potentially risks crowding out proposed capacity additions which may otherwise occur on other routes based on passenger demand.
375. However, as noted, the ACCC considers that the competitive constraint that Qantas and China Eastern, as the two major carriers on this route, impose on each other is likely to be lost if the Proposed Conduct proceeds. Reflecting the ACCC's concerns about the impact of the Proposed Conduct on competition on this route the ACCC is able to apply a CAGR specifically on the Sydney – Shanghai route at any time during the term of the authorisation. Before deciding the vary the CAGR the ACCC must conduct a review, including consulting with

the Applicants and undertaking any other consultation the ACCC considers necessary. Factors the ACCC may have regard to in conducting a review include current market conditions, airlines current and future planned capacity growth, available forecasts of passenger demand and the impact of the variation on route profitability.

376. Similarly, the ACCC can also review and vary the CAGR applied in aggregate across all routes between Shanghai and Australia at any time.
377. The ACCC is not able increase the CAGR following a review by more than the weighted average of Australian and Chinese annual GDP growth with the weighting attached to each GDP measure reflecting the proportion of passengers on relevant routes from Australia and China. As with the CAGR applying across all routes between Shanghai and Australia any CAGR imposed by the ACCC on the Sydney – Shanghai route is subject to the weighted average GDP cap.
378. The Applicants are also able to apply for a variation to the conditions in exceptional circumstances, if there has been a material change in market conditions or they have suffered material adverse financial performance. As with an ACCC review of the CAGR, the ACCC may consult on the proposal to vary the conditions.
379. The Applicants are required to report each scheduling season on seats and passengers flown (including separately reporting point to point and connecting passengers) route specific costs and revenues and average fares.
380. The revenue, cost and load factor information (seats flown versus passengers flown) will assist in gauging during the term of the authorisation whether the CAGR, and particularly whether the Sydney – Shanghai CAGR, initially set at zero, is set too high or too low. It will also provide an indication of whether fares on the Sydney – Shanghai route are rising relative to costs, both in absolute terms and compared to other routes flown by the Applicants. This, along with other information required to be reported will assist in assessing whether capacity is keeping pace with growth in demand.
381. This information will also evidence any instance of Qantas and/or China Eastern raising fares on the Sydney – Shanghai point to point route, relative to other routes between Australia and China.
382. Further, the requirement to report this information, coupled with the ability for the ACCC to review the Shanghai – Australia CAGR and impose a Sydney – Shanghai specific CAGR at any time is likely in itself act as a constraint on the Applicants in setting prices and allocating capacity on the Sydney – Shanghai route.
383. If Qantas and/or China Eastern did raise their prices on the Sydney – Shanghai route, relative to other routes between Australia and China, this would be likely to generate a significant public detriment which would be relevant to the ACCC's assessment of the public benefits and detriments likely to result from the alliance in considering any application for re-authorisation.
384. The information the Applicants are required to report will also illustrate the extent to which the Proposed Conduct facilitates the development of China Eastern's Shanghai hub as a gateway to greater China for Australian passengers. In

particular, the ACCC expects this reporting to reflect a significantly increase in the number of passengers flying beyond Shanghai with China Eastern. Were this not the case this would call into question the Applicants arguments about the Proposed Conduct facilitating this gateway strategy. This will also be an important consideration in the ACCC's assessment of any application for re-authorisation.

Length of authorisation

385. The CCA allows the ACCC to grant authorisation for a limited period of time.³⁶ This allows the ACCC to be in a position to be satisfied that the likely public benefits will outweigh the detriment for the period of authorisation. It also enables the ACCC to review the authorisation and the public benefits and detriments that have resulted after an appropriate period.
386. In this instance, the Applicants seek authorisation for five years.
387. As noted above, the ACCC has significant concerns about the impact on competition of the Proposed Conduct on the Sydney – Shanghai route. The conditions imposed by the ACCC are designed to mitigate the resultant public detriment.
388. The ACCC also considers that the Proposed Conduct is likely to result in significant public benefits. The ACCC notes that many of these benefits are dependent on operation changes the Applicants will need to make if authorisation is granted. For example, co-locating in China Eastern's terminal in Shanghai, introducing new frequencies and destinations and expanding the scope of routes covered by existing codeshare arrangements. Accordingly, these public benefits will likely take some time to be realised once the authorisation comes into effect.
389. Accordingly, the ACCC considers that it is appropriate to grant authorisation for the five years sought by the Applicants and grants conditional authorisation until 31 October 2020 being the approximate end date of the 2020 northern winter scheduling season.

³⁶ Subsection 91(1) of the CCA.

Determination

The applications

390. On 18 November 2014, the Applicants lodged applications for authorisation A91470 and A91471 with the ACCC. Application A91470 was made using Form A Schedule 1, of the Competition and Consumer Regulations 2010. Application A91471 was made using Form B Schedule 1, of the Competition and Consumer Regulations 2010.
391. The applications were made under subsection 88 (1) and (1A) of the CCA to give effect to a Joint Coordination Agreement under which the Applicants will coordinate their operations between Australia and China.
392. The Applicants seek authorisation of the Joint Coordination Agreement as it may contain a cartel provision or may have the purpose or effect of substantially lessening competition or contain an exclusionary provision within the meaning of section 45 of the CCA.

The net public benefit test

393. For the reasons outlined in this determination, subject to the conditions below, the ACCC is satisfied, pursuant to sections 90(5B) and 90(7) of the CCA, that in all the circumstances the conduct for which authorisation is sought is likely to result in a public benefit that would outweigh any likely detriment to the public constituted by any lessening of competition arising from the Proposed Conduct.
394. For the reasons outlined in this determination, subject to the conditions below, the ACCC is satisfied, pursuant to section 90(8), that the conduct for which authorisation is sought is likely to result in such a benefit to the public that the Proposed Conduct should be allowed to take place.
395. The ACCC therefore grants authorisation to applications A91470 & A91471 subject to the conditions set out in Attachment B.

Conduct for which the ACCC grants authorisation

396. The ACCC grants authorisation, subject to the conditions set out in Attachment B, for Qantas and China Eastern to give effect to the Coordination Agreement which enables them to coordinate their operations between Australia and China.

Date authorisation comes into effect

397. This determination is made on 21 August 2015. If no application for review is made to the Australian Competition Tribunal (The Tribunal), it will come into force on 12 September 2015.

Attachment A – Relevant public benefit tests in CCA

Subsections 90(5B) provides that the ACCC shall not authorise a provision of a proposed contract, arrangement or understanding that is or may be a cartel provision, unless it is satisfied in all the circumstances that:

- the provision, in the case of subsection 90(5A) would result, or be likely to result, or in the case of subsection 90(5B) has resulted or is likely to result, in a benefit to the public; and
- that benefit, in the case of subsection 90(5A) would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement were made or given effect to, or in the case of subsection 90(5B) outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted or is likely to result from giving effect to the provision.

Subsections 90(7) states that the ACCC shall not authorise a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:

- the provision of the proposed contract, arrangement or understanding in the case of subsection 90(6) would result, or be likely to result, or in the case of subsection 90(7) has resulted or is likely to result, in a benefit to the public; and
- that benefit, in the case of subsection 90(6) would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement was made and the provision was given effect to, or in the case of subsection 90(7) has resulted or is likely to result from giving effect to the provision.

Subsection 90(8) states that the ACCC shall not:

- make a determination granting:
 - i. an authorisation under subsection 88(1) in respect of a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision; or
 - ii. an authorisation under subsection 88(7) or (7A) in respect of proposed conduct; or
 - iii. an authorisation under subsection 88(8) in respect of proposed conduct to which subsection 47(6) or (7) applies; or
 - iv. an authorisation under subsection 88(8A) for proposed conduct to which section 48 applies;

unless it is satisfied in all the circumstances that the proposed provision or the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed contract or arrangement should be allowed to be made, the proposed understanding should be allowed to be arrived at, or the proposed conduct should be allowed to take place, as the case may be; or

- make a determination granting an authorisation under subsection 88(1) in respect of a provision of a contract, arrangement or understanding that is or may be an exclusionary provision unless it is satisfied in all the circumstances that the provision has resulted, or is likely to result, in such a benefit to the public that the contract, arrangement or understanding should be allowed to be given effect to.

Attachment B – Conditions of Authorisation

APPLICATIONS FOR AUTHORISATION A91470 & A91471 – CONDITIONS

OBJECTIVE

These Conditions require the Applicants to maintain a base level of capacity on Routes between Australia and Shanghai for Scheduling Seasons commencing during the Term and to increase capacity on Routes between Australia and Shanghai over the Term.

The Applicants are required to maintain their pre-Alliance aggregated capacity on the Sydney – Shanghai city pair. The Applicants are not initially required to grow capacity on this city pair. The Applicants are required to grow capacity in aggregate across all Routes between Australia and Shanghai by a compound annual growth rate of 4% over the term of the authorisation. The ACCC may over the term of the authorisation decide, following a review, to also require the Applicants to grow capacity on the Sydney – Shanghai city pair.

Any obligation to grow capacity, on the Sydney – Shanghai city pair or in aggregate across Routes between Australia and Shanghai is subject to review by the ACCC to consider whether an increase or decrease in the minimum requirements is warranted.

The Conditions also require the Applicants to provide information to the ACCC on an ongoing basis in relation to the Alliance.

The ACCC may vary the Conditions in exceptional circumstances, or where there is a material change in market conditions or financial performance.

1. MINIMUM SEAT CAPACITY CONDITIONS

- (a) For each Scheduling Season which commences during the Term, the Applicants must make available not less than 100 per cent of the applicable Sydney – Shanghai City Pair Scheduling Season Base Year Seat Capacity.
- (b) Initially, the Applicants are not required to grow capacity on the Sydney – Shanghai city pair. If at any time over the Term the ACCC decides, following a review, to require the Applicants to grow capacity on the Sydney – Shanghai city pair, on a rolling basis over the Term, the Applicants must increase the applicable Sydney-Shanghai City Pair Scheduling Season Base Year Seat Capacity by not less than the Sydney-Shanghai CAGR set by the ACCC.
- (c) For each Scheduling Season which commences during the Term, the Applicants must make available not less than 100 per cent of the applicable Australia – Shanghai Scheduling Season Base Year Seat Capacity. To avoid doubt, this obligation requires the Applicants to make the specified capacity available in aggregate across all Routes between Australia and Shanghai.
- (d) On a rolling basis over the Term, the Applicants must increase the applicable Australia – Shanghai Scheduling Season Base Year Seat Capacity by not less than the Australia – Shanghai CAGR. To avoid doubt:

- (i) this obligation requires the Applicants to make the specified capacity available in aggregate across all Routes between Australia and Shanghai;
- (ii) any capacity the Applicants make available in accordance with clause 1(b) is also capacity made available in accordance with the Applicants obligations under this clause 1(d).

2. REPORTING OBLIGATIONS

- (a) Within three months of the end of each Scheduling Season during the Term, the Applicants must provide, for each month of the previous Scheduling Season, the following information to the ACCC for all Routes between Shanghai and Australia flown by either or both of the Applicants:
 - (i) the total number of seats flown by the Applicants by cabin class on each Route;
 - (ii) the total number of passengers identifying separately
 - (a) Point to Point Passengers and
 - (b) Connecting Passengers, identified by the destination travelled to and/or from

flown by the Applicants by cabin class on each Route;
 - (iii) for each Applicant separately, and for the Alliance, total revenue on each Route by cabin class reported separately for Australian originated sales and China originated sales, in accordance with the information that is retained in their financial accounting system;
 - (iv) if the revenue figures provided in accordance with clause 2(a)(iii) do not include all ancillary charges (including but not limited to in-flight food and entertainment purchases and excess or additional baggage purchases), the total amount of ancillary charges:
 - (a) for each Route, where that information is available to the Applicant; and
 - (b) as a total for all Routes between Australia and Shanghai,

in accordance with the relevant Applicant's financial accounting systems;
 - (v) for each Applicant separately, operating cost on each Route, both in total and disaggregated by fixed and variable costs as is reported in the relevant Applicant's financial accounting systems, including but not limited to:
 - (a) all direct costs;

- (b) fixed operating costs; and
 - (c) an allocation of overheads.
- (b) Within three months of the end of each Scheduling Season during the Term, each of the Applicants must separately provide to the ACCC, for each month of the previous Scheduling Season, the average fare by cabin class for each Service, reported separately for Australian originated sales and China originated sales.
 - (c) The Applicants must provide a written description of the methodology used to calculate the revenue and cost figures provided in accordance with clauses 2(a)(iii) and (v), and the ancillary charge figures provided in accordance with clause 2(a)(iv) which description must include particulars of:
 - (i) all inclusions (e.g., any taxes or surcharges) and exclusions; and
 - (ii) any changes to the Applicants' methodology compared to the methodology used for reporting under this clause 2 for the previous Scheduling Season.
 - (d) The information in this clause 2 must be provided to the ACCC in an accessible spreadsheet format.

3. ADJUSTMENT TO SCHEDULING SEASON BASE YEAR CAPACITY

3.1 Northern Summer Season

- (a) On or before 31 January 2016, the Applicants must provide the ACCC with:
 - (i) **confirmed** Australia – Shanghai Scheduling Season Base Year Seat Capacity and Sydney – Shanghai City Pair Scheduling Season Base Year Seat Capacity figures from BITRE for the NS Season ending 31 October 2015, for those figures in Schedule A to these Conditions which are identified as being **provisional**; and
 - (ii) for each Applicant, the Route Profitability Information for each Route for each month of the Base Year.
- (b) In relation to clause 3.1(a)(i), the ACCC may undertake any consultation it considers necessary in relation to the confirmed figures provided by the Applicants.
- (c) After considering the information provided by the Applicants in accordance with clause 3.1(a)(i), the outcome of any consultation undertaken in accordance with clause 3.1(b), and any other information the ACCC considers relevant, the ACCC may decide to adjust the provisional figures in Schedule A to these Conditions.

- (d) The ACCC will give notice in writing to the Applicants of its decision on whether to adjust the provisional figures in Schedule A to these Conditions in accordance with clause 3.1(c) above.
- (e) Any such adjustment will come into effect from the next NS Season after the date of the ACCC decision or such other date as determined by the ACCC, and the figures in Schedule A so adjusted will apply for the remainder of the Term, unless subject to further adjustment pursuant to clause 3.2.
- (f) If the ACCC decides not to adjust the provisional figures in Schedule A in accordance with clause 3.1(c), the provisional figures in Schedule A will be taken as confirmed and will apply for the remainder of the Term, unless subject to further adjustment pursuant to clause 3.2.

3.2 Changes to BITRE's methodology for reporting the number of seats flown

- (a) If BITRE changes its methodology for reporting the number of seats flown on the Routes from that which was used to calculate the Australia – Shanghai Scheduling Season Base Year Seat Capacity and Sydney – Shanghai City Pair Scheduling Season Base Year Seat Capacity figures in Schedule A, then the ACCC may adjust the Australia – Shanghai Scheduling Season Base Year Seat Capacity and/or Sydney – Shanghai City Pair Scheduling Season Base Year Seat Capacity figures in Schedule A to reflect BITRE's new methodology.
- (b) In relation to clause 3.2(a), the ACCC will consult with the Applicants prior to making any adjustment.
- (c) The ACCC will give notice in writing to the Applicants of its decision on whether to adjust the figures in Schedule A in accordance with clause 3.2(a).
- (d) Any adjustment made under clause 3.2(a) will come into effect on a date that is determined by the ACCC.

4. ACCC REVIEW REGARDING AUSTRALIA – SHANGHAI CAGR AND SYDNEY – SHANGHAI CAGR

- (a) The ACCC may, at any time and in its absolute discretion, conduct a review of these Conditions, to determine whether to vary the Australia – Shanghai CAGR and/or the Sydney – Shanghai CAGR and may, in its absolute discretion, vary the Australia – Shanghai CAGR and/or the Sydney – Shanghai CAGR subject to clause 4(e).
- (b) When conducting a review, the ACCC must consult with the Applicants and allow the Applicants an opportunity to make submissions within a specified

period. The ACCC may publish or otherwise make publicly available the Applicants' submissions in relation to a review under this clause 4.

- (c) When conducting a review, the ACCC may undertake such further consultation as it considers necessary, including inviting submissions within a specified period from the Applicants and interested parties.
- (d) Without limiting the matters the ACCC may take into account for the purpose of determining whether to vary these Conditions pursuant to clause 4(a), the ACCC must have regard to the following matters:
 - (i) current market conditions on Australia – China Routes;
 - (ii) airlines' current and planned future capacity growth on Australia – China Routes;
 - (iii) available forecasts of passenger demand on Australia – China Routes;
 - (iv) the size and type of aircraft operated by the Applicants;
 - (v) regulatory constraints on either of the Applicants' ability to operate on each Route
 - (vi) the Applicants ability to obtain relevant airport slots; and
 - (vii) the impact of the variation on Route Profitability on each Route.
- (e) The ACCC must not make a determination to adjust the Conditions to:
 - (i) increase the Australia – Shanghai CAGR pursuant to clause 4(a) by more than the Australia – Shanghai CAGR Increase Cap; or
 - (ii) increase Sydney – Shanghai CAGR pursuant to clause 4(a) by more than the Sydney – Shanghai CAGR Increase Cap.
- (f) The ACCC, having had regard to submissions received from the Applicants and any other interested parties and any other information the ACCC considers relevant, will advise the Applicants in writing of its decision, following its review, of whether to adjust the Conditions to vary the Australia – Shanghai CAGR and/or the Sydney – Shanghai CAGR in accordance with clause 4(a).

- (g) The reporting requirement in clause 2 continues irrespective of whether the ACCC is conducting a review under this clause 4.

5. VARIATIONS TO THE CONDITIONS

5.1 Applications to vary the Conditions

- (a) The Applicants may apply in writing to the ACCC for a variation to the Conditions, in the following circumstances:
 - (i) Exceptional Circumstances;
 - (ii) Material Change in Market Conditions; or
 - (iii) Material Adverse Financial Performance.
- (b) Any application by the Applicants to the ACCC for a variation to the Conditions must state the nature of the variation sought and the circumstances claimed by the Applicants and must be accompanied by evidence supporting the application.
- (c) The ACCC will consult with the Applicants in relation to the application for variation to the Conditions and allow the Applicants an opportunity to make submissions within a specified period.
- (d) The ACCC may request from the Applicants any additional information required by the ACCC to assess the application for a variation of the Conditions.
- (e) The ACCC may undertake any further consultation as it considers necessary to consider any such request for a variation to the Conditions, including inviting submissions from interested parties.
- (f) In undertaking an assessment of an application to vary the Conditions, the ACCC may publish or otherwise make publicly available the Applicants' submissions in support of their request for variation and to any submissions made by the interested parties.
- (g) Without limiting the matters to which the ACCC may have regard for the purpose of determining whether to vary the Conditions (including whether a Material Change in Market Conditions has occurred), the ACCC must have regard to any entry or expansion by airlines other than the Applicants on any Route and any commencement of services by the Applicants on any Australia – China Route that neither of the Applicants serviced at the commencement of the Term.
- (h) After considering an application to vary the Conditions and any submissions received in respect of such an application, the ACCC may, in its absolute

discretion, determine to vary the Conditions or dismiss the application for variation.

- (i) The ACCC may vary the Conditions subject to any conditions as the ACCC sees fit.
- (j) The ACCC will advise the Applicants in writing of its decision in respect of an application for variation made under clause 5(a).
- (k) If the ACCC determines to vary the Conditions, the variation will be effective from the date determined by the ACCC.

5.2 ACCC may make minor variations

- (a) Notwithstanding clause 5.1 above, the ACCC may vary the Conditions at any time, provided that:
 - (i) the variation does not involve a material change in the effect of the Conditions; and
 - (ii) prior to making the variation, the ACCC has obtained the Applicants' consent, in writing, to the variation.
- (b) The ACCC will advise the Applicants in writing of any variation made in accordance with 5.2(a).
- (c) Any variation to the Conditions made under this clause 5.2 will be effective from the date notified to the Applicants by the ACCC.

6. AUDIT OF COMPLIANCE

6.1 Obligation to appoint an independent auditor

- (a) The Applicants must appoint and maintain an independent auditor to audit and report to the ACCC with respect to the compliance by the Applicants with clause 1 of these Conditions.

6.2 Proposed Auditor

- (a) By 30 November 2015, the Applicants must identify a prospective independent auditor (**Proposed Independent Auditor**) and provide the ACCC with a notice for a Proposed Independent Auditor in the form prescribed in Schedule B to these Conditions (**Proposed Independent Auditor Notice**), including draft terms of appointment and a draft audit plan.
- (b) The ACCC shall have the discretion to approve or reject in writing the Proposed Independent Auditor identified in the Proposed Independent Auditor Notice.

- (c) Without limiting the ACCC's discretion, in deciding whether to approve a Proposed Independent Auditor, the factors to which the ACCC may have regard include whether the:
 - (i) person named in the Proposed Independent Auditor Notice or identified by the ACCC has the qualifications and experience necessary to carry out the functions of the Approved Independent Auditor;
 - (ii) person named in the Proposed Independent Auditor Notice or identified by the ACCC is sufficiently independent of the Applicants;
 - (iii) draft terms of appointment and the draft audit plan are consistent with these Conditions; and
 - (iv) draft terms of appointment and the draft audit plan are otherwise acceptable to the ACCC.

6.3 Appointment of the Approved Independent Auditor

After receiving a written notice from the ACCC of its approval of a Proposed Independent Auditor, the draft terms of appointment and draft audit plan, the Applicants must, within five Business Days:

- (a) appoint the person approved by the ACCC as the Approved Independent Auditor on the Approved Terms of Appointment; and
- (b) forward to the ACCC a copy of the executed Approved Terms of Appointment.

6.4 Failure to appoint

If the Approved Independent Auditor has not been appointed:

- (a) by 18 December 2015;
- (b) within 15 Business Days after the Approved Independent Auditor resigns or otherwise ceases to act as the Approved Independent Manager pursuant to clauses 6.8(a) or 6.8(b) or 6.8(c); or
- (c) if the ACCC has not received a Proposed Independent Auditor Notice pursuant to clause 6.2(a);

then, the ACCC at its absolute discretion may:

- (d) identify and approve a person as the Approved Independent Auditor, including approving the draft terms of appointment and draft audit plan; and/or
- (e) direct the Applicants to appoint a person who the ACCC has deemed is an Approved Independent Auditor.

6.5 Obligations and powers of the Approved Independent Auditor

The applicants must procure that any proposed terms of appointment for the Approved Independent Auditor include obligations on the Approved Independent Auditor to:

- (a) maintain his or her independence from the Applicants, apart from appointment to the role of Approved Independent Auditor, including not form any relationship of the types described in paragraph 2(c) of Schedule B to these Conditions with the Applicants for the period of his or her appointment;
- (b) conduct compliance auditing according to the Approved Audit Plan;
- (c) provide the following reports directly to the ACCC:
 - (i) a scheduled written Audit Report as described in clause 6.6(c); and
 - (ii) an immediate report of any issues that arise in relation to the performance of his or her functions as Approved Independent Auditor or in relation to compliance with these Conditions by any person named in these Conditions; and
- (d) follow any direction given to him or her by the ACCC in relation to the performance of his or her functions as Approved Independent Auditor under these Conditions.

The Applicants must procure that any proposed terms of appointment for the Approved Independent Auditor provide the Approved Independent Auditor with the authority to:

- (e) access any information or documents that the Approved Independent Auditor considers necessary for carrying out his or her functions as the Approved Independent Auditor or for reporting to or otherwise advising the ACCC; and
- (f) engage any external expertise, assistance or advice required by the Approved Independent Auditor to perform his or her functions as the Approved Independent Auditor.

6.6 Compliance audit

- (a) The Approved Independent Auditor must within three months of the end of a Scheduling Season, provide to the ACCC a written Audit Report as set out in clauses 6.6(b) and (c) in relation to the Applicant's compliance with its obligations under clause 1.
- (b) The Audit Report must be conducted to a Reasonable Assurance standard.
- (c) The Approved Independent Auditor must conduct an audit and prepare a detailed report (**Audit Report**) that includes:

- (i) the Approved Independent Auditor's procedures in conducting the audit, or any change to audit procedures and processes since the previous Audit Report;
- (ii) a full audit of the Applicant's compliance with these Conditions;
- (iii) identification of any areas of uncertainty or ambiguity in the Approved Independent Auditor's interpretation of any obligations contained in these Conditions;
- (iv) all of the reasons for the conclusions reached in the Audit Report;
- (v) any qualifications made by the Approved Independent Auditor in forming his or her views;
- (vi) any recommendations by the Approved Independent Auditor to improve:
 - (1) the Approved Audit Plan;
 - (2) the integrity of the auditing process;
 - (3) the Applicant's processes or reporting systems in relation to compliance with these Conditions; and
 - (4) the Applicant's compliance with these Conditions; and
 - (5) the implementation and outcome of any prior recommendations by the Approved Independent Auditor.
- (d) The Approved Independent Auditor must provide the Applicants with a draft Auditor's Report prior to it being provided to the ACCC, for the sole purpose of the Applicants having the opportunity to identify any factual errors. The Approved Independent Auditor retains complete discretion as to whether to accept or reject any corrections of factual errors proposed by the Applicants. Where corrections are accepted by the Approved Independent Auditor, the Approved Independent Auditor will provide the ACCC with details of the corrections proposed by the Applicants and accepted by the Approved Independent Auditor.
- (e) The Applicants must implement any recommendations made by the Approved Independent Auditor in Audit Reports, and notify the ACCC of the implementation of the recommendations, within 10 Business Days after receiving the Audit Report or such other period agreed as agreed in writing with the ACCC.
- (f) The Applicants must comply with any direction of the ACCC in relation to the matters arising from any Audit Report, within 10 Business Days of being so directed to do so (or such longer period as is agreed with the ACCC).

6.7 Applicant's obligations in relation to the Approved Independent Auditor

Without limiting its obligations in these Conditions, the Applicants must:

- (a) comply with and enforce the Approved Terms of Appointment for the Approved Independent Auditor;
- (b) maintain and fund the Approved Independent Auditor to carry out his or her functions including:
 - (i) indemnifying the Approved Independent Auditor for any expenses, loss, claim or damage arising directly or indirectly from the performance by the Approved Independent Auditor of his or her functions as the Approved Independent Auditor except where such expenses, loss, claim or damage arises out of the gross negligence, fraud, misconduct or breach of duty by the Approved Independent Auditor;
 - (ii) providing and paying for any external expertise, assistance or advice required by the Approved Independent Auditor to perform his or her functions as the Approved Independent Auditor; and
- (c) not interfere with, or otherwise hinder, the Approved Independent Auditor's ability to carry out his or her functions as the Approved Independent Auditor, including:
 - (i) directing the Applicants personnel, including directors, contractors, managers, officers, employees and agents, to act in accordance with this clause 6.7;
 - (ii) providing access to the facilities, sites or operations of the Applicants businesses as required by the Approved Independent Auditor;
 - (iii) providing to the Approved Independent Auditor any information or documents he or she considers necessary for carrying out his or her functions as the Approved Independent Auditor or for reporting to or otherwise advising the ACCC;
 - (iv) not requesting any information relating to the compliance audit from the Approved Independent Auditor without such a request having been approved by the ACCC; and
 - (v) not appointing the Approved Independent Auditor, or have any Agreements with the Approved Independent Auditor, to utilise the Approved Independent Auditor's services for anything other than compliance with this Undertaking until at least 12 months after the Approved Independent Auditor ceases to act in the role of the Approved Independent Auditor.

6.8 Resignation, revocation or termination of the Approved Independent Auditor

- (a) The Applicants must immediately notify the ACCC in writing in the event that the Approved Independent Auditor resigns or otherwise stops acting as the Approved Independent Auditor before the termination of this Authorisation.

- (b) The ACCC may revoke an Approved Independent Auditor's status as the Approved Independent Auditor if the ACCC becomes aware that any information provided to it was incorrect, accurate or misleading.
- (c) The ACCC may approve any proposal by, or alternatively may direct, the Applicants to terminate the appointment of the Approved Independent Auditor if in the ACCC's view the Approved Independent Auditor acts inconsistently with the provisions of these Conditions or the Approved Terms of Appointment.

7. INFORMATION

- (a) The Applicants must respond as soon as practicable to any queries or requests for information or documents made by the ACCC pursuant to or in relation to these Conditions.
- (b) The ACCC may direct the Applicants in respect of their compliance with these Conditions to, and the Applicants must:
 - (i) furnish information, documents and materials to the ACCC in the time and in the form requested by the ACCC;
 - (ii) produce information, documents and materials to the ACCC within the Applicants' custody, power or control in the time and in the form requested by the ACCC; and/or
 - (iii) attend the ACCC at a reasonable time and place appointed by the ACCC to answer any questions the ACCC (including its Commissioners, its staff or its agents) may have.
- (c) In respect of the Applicants' compliance with these conditions or the Approved Independent Auditor's compliance with its Approved Terms of Appointment, the ACCC may request the Approved Independent Auditor to:
 - (i) furnish information, documents and materials to the ACCC in the time and in the form requested by the ACCC;
 - (ii) produce information, documents and materials to the ACCC within the Approved Independent Auditor's custody, power or control in the time and in the form requested by the ACCC; and/or
 - (iii) attend the ACCC at a time and place appointed by the ACCC to answer any questions the ACCC (its Commissioners, its staff or its agents) may have.
- (d) The Applicants will use their best endeavours to ensure that the Approved Independent Auditor complies with any request from the ACCC in accordance with clause 7(c).
- (e) Information furnished, documents and material produced or information given in response to any request or direction from the ACCC under these Conditions may be used by the ACCC for any purpose consistent with the exercise of its statutory duties and functions.

- (f) The ACCC may in its discretion to be exercised in good faith:
 - (i) advise the Approved Independent Auditor of any request made by it under this clause 7; and/or
 - (ii) provide copies to the Independent Auditor of any information furnished, documents and material produced or information given to it under this clause 7.
- (g) Nothing in these Conditions requires the provision of information or documents in respect of which either of the Applicants claim legal professional or other privilege.

8. DEFINITIONS AND INTERPRETATION

ACCC means the Australian Competition and Consumer Commission.

Alliance means the alliance between the Applicants pursuant to the Joint Coordination Agreement dated 17 November 2014.

Applicants Qantas Airways Limited (**Qantas**), China Eastern Airlines Corporation Limited (**China Eastern**) and their related bodies corporate

Approved Audit Plan means the plan approved by the ACCC in accordance with the terms of these Conditions, by which the Approved Independent Auditor will audit and report upon compliance with these Conditions.

Approved Independent Auditor means the person approved by the ACCC and appointed under clause 6 of these Conditions.

Approved Terms of Appointment means the terms of appointment for the Approved Independent Auditor as approved by the ACCC in accordance with the terms of these Conditions.

Associated Entity has the meaning given by section 50AAA of the Corporations Act.

Audit Report has the meaning given to it in clause 6.6(c) of these Conditions.

Australia – China Route means any Route between a particular location in Australia and a particular location in China.

Australia – Shanghai CAGR means the compound annual growth rate of 4% and as:

- (a) adjusted as determined by the ACCC pursuant to clause 4(a) of these Conditions; or
- (b) varied in accordance with clause 5 of these Conditions.

Australia – Shanghai CAGR Increase Cap is $((AUSPAX / TOTALPAX) \times AUDGDP) + ((CHPAX / TOTALPAX) \times CHGDP)$ where:

AUSPAX means total number of flight segments sold by the Applicants in Australia for travel on Routes between Australia and Shanghai, or vice versa, between 1 November 2015 and the end of the later of the NS Season or NW Season which finishes immediately prior to the ACCC commencing a review under clause 4.

CHPAX means total number of flight segments sold by the Applicants in China for travel on Routes between Australia and Shanghai, or vice versa, between 1 November 2015 and the end of the later of the NS Season or NW Season which finishes immediately prior to the ACCC commencing a review under clause 4.

TOTALPAX means total number of flight segments sold by the Applicants in Australia and China for travel on Routes between Australia and Shanghai, or vice versa, between 1 November 2015 and the end of the later of the NS Season or NW Season which finishes immediately prior to the ACCC commencing a review under clause 4.

AUSGDP means the sum of quarterly changes in Australia's Trend Chain Volume GDP, as published by the Australian Bureau of Statistics in Catalogue No 5206.0, data series A2298668K, commencing from the September – December 2015 quarterly change.

CHGDP means the sum of quarterly changes in China's GDP as published by the National Bureau of Statistics of China commencing from the September – December 2015 quarterly change.

Australia – Shanghai Scheduling Season Base Year Seat Capacity means the Applicants' combined total number of seats flown on Routes between Australia and Shanghai in, as applicable, the NS Season or the NW Season in the Base Year as set out in Schedule A of these Conditions, and as adjusted in accordance with clause 3 of these Conditions.

Authorisation means the determination by the ACCC regarding applications for authorisation A91470 and A91471.

Base Year means the 12 month period from 1 November 2014 to 31 October 2015.

BITRE means the Bureau of Infrastructure, Transport, and Regional Economics.

Business Day means a day that is not a Saturday, Sunday, or public holiday in the Australian Capital Territory, New South Wales or Shanghai.

Conditions mean these conditions (including Schedule A) subject to which the Authorisation is granted.

Connecting Passenger means any passenger carried by an Applicant on a single Route starting in Australia and ending in China, or vice versa, who before or after that Route, as part of the same journey, travels from or to another destination (domestic or international) operated by Qantas or China Eastern.

Corporations Act means the *Corporations Act 2001* (Cth)

Entities Connected has the meaning given by section 64B of the Corporations Act.

Exceptional Circumstances include:

- (a) force majeure events, including natural disasters, national emergency, insurrection, riot, war, pandemic; or
- (b) events or factors outside of the control of the Applicants:
 - (i) such that the Applicants cannot, or on reasonable grounds anticipate that they cannot, practically comply with the Conditions; or
 - (ii) which have or are reasonably anticipated to have a material adverse impact on the demand for travel on the Applicants' services or the Applicants' service operating costs, or affecting operations on the Relevant Routes.

Filed Travel Period means the travel period for which the relevant fare is valid, as communicated in the Applicants' fare rules in the Applicants' internal booking engine(s) or via the Global Distribution System.

Material Adverse Financial Performance means an actual decline in Route Profitability (whether the result is a profit or a loss) for the one or both of the Applicants which the ACCC agrees in writing is material on:

- (a) a Route;
- (b) more than one Route; or
- (c) all Routes;

when compared to the relevant Route Profitability of each of or both of (as applicable) the Applicants in the Base Year.

Material Change in Market Conditions means a change to the market conditions which the ACCC agrees in writing to be material on:

- (a) a Route;
- (b) more than one Route; or
- (c) all Routes.

NS Season means the northern summer season from 1 April to 31 October.

NW Season means the northern winter season from 1 November to 31 March.

Point to Point Passenger means any passenger carried by an Applicant on a single Route starting in Australia and ending in Shanghai, or vice versa.

Proposed Independent Auditor means a person named in a Proposed Independent Auditor Notice.

Proposed Independent Auditor Notice has the meaning given to it in clause 6.2(a) of these Conditions.

Reasonable Assurance audit means an audit conducted pursuant to a 'reasonable assurance' engagement in accordance with the Australian Auditing Standards, and in particular ASAE3000 'Assurance Engagements other than Audits or Reviews of Historical Financial Information'.

Related Entities has the meaning given to it by section 9 of the *Corporations Act 2001* (Cth).

Related Parties has the meaning given to it by section 228 of the *Corporations Act 2001* (Cth).

Route means any city pair between Shanghai and a city in Australia flown by either or both of the Applicants during the Term.

Route Profitability: means the profit (or loss) on a Route (which may be represented in terms of a net margin, that is, net Route profit expressed as a percentage of total Route revenue) determined in accordance with the relevant Applicant's usual management accounting methodology (that is, the same methodology that Applicant uses to determine Route profitability on all other Routes).

Route Profitability Information: means information regarding the profit (or loss) on a Route accompanied by reports including categorised details of revenues and costs and an explanation of the relevant revenue and cost categories, determined in accordance with the relevant Applicant's usual management accounting methodology (that is, the same methodology that Applicant uses to determine Route profitability on all other Routes).

Scheduling Season: means either the NS Season or the NW Season.

Service means any itinerary offered by Qantas or China Eastern:

- (a) starting in Australia and ending in China, or vice versa;
- (b) starting and ending in Australia and including at least one destination in China and no destinations in any other country; or
- (c) starting and ending in China and including at least one destination in China and no destinations in any other country

comprising one or more flight segments (including domestic flight segments) available on a single ticket.

Sydney – Shanghai CAGR: means the compound annual growth rate of 0%, and as:

- (a) adjusted as determined by the ACCC pursuant to clause 4(a) of these Conditions; or

(b) varied in accordance with clause 5 of these Conditions.

Sydney – Shanghai CAGR Increase Cap is $((\text{AUSPAXSS} / \text{TOTALPAXSS}) \times \text{AUDGDP}) + ((\text{CHPAXSS} / \text{TOTALPAXSS}) \times \text{CHGDP})$ where:

AUSPAXSS means total number of flight segments sold by the Applicants in Australia for travel on the Sydney – Shanghai city pair between 1 November 2015 and the end of the later of the NS Season or NW Season which finishes immediately prior to the ACCC commencing a review under clause 4.

CHPAXSS means total number of flight segments sold by the Applicants in China for travel on the Sydney – Shanghai city pair between 1 November 2015 and the end of the later of the NS Season or NW Season which finishes immediately prior to the ACCC commencing a review under clause 4.

TOTALPAXSS means: total number of Australian originated tickets sold by the Applicants and China originated tickets sold by the Applicants for travel on the Sydney – Shanghai city pair between 1 November 2015 and the end of the later of the NS Season or NW Season which finishes immediately prior to the ACCC commencing a review under clause 4.

AUSGDP means the sum of quarterly changes in Australia's Trend Chain Volume GDP, as published by the Australian Bureau of Statistics in Catalogue No 5206.0, data series A2298668K, commencing from the September – December 2015 quarterly change.

CHGDP means the sum of quarterly changes in China's GDP as published by the National Bureau of Statistics of China commencing from the September – December 2015 quarterly change.

Sydney – Shanghai City Pair Scheduling Season Base Year Seat Capacity: means the Applicants' combined total number of seats flown on the Sydney – Shanghai city pair in, as applicable, the NS Season or the NW Season in the Base Year as set out in Schedule A of these Conditions, and as adjusted in accordance with clause 3 of these Conditions.

Term: means the term of the Authorisation.

Interpretation

In the interpretation of these Conditions, the following apply unless the context otherwise requires:

- (a) a reference to these Conditions includes its schedules;
- (b) headings are inserted for convenience only and do not affect the interpretation of these Conditions;
- (c) if the day on which any act, matter or thing is to be done under these Conditions is not a Business Day, the act, matter or thing must be done on the next Business Day;

- (d) a reference in these Conditions to any law, legislation or legislative provision includes any statutory modification, amendment or re-enactment, and any subordinate legislation or regulations issued under that legislation or legislative provision;
- (e) a reference in these Conditions to any company includes its Related Bodies Corporate;
- (f) a reference in these Conditions to any agreement or document is to that agreement or document as amended, novated, supplemented or replaced;
- (g) a reference to a clause, part, schedule or attachment is a reference to a clause, part, schedule or attachment of or to these Conditions;
- (h) an expression importing a natural person includes any company, trust, partnership, joint venture, association, body corporate or governmental agency;
- (i) where a word or phrase is given a defined meaning, another part of speech or other grammatical form in respect of that word or phrase has a corresponding meaning;
- (j) a word which denotes the singular also denotes the plural, a word which denotes the plural also denotes the singular, and a reference to any gender also denotes the other genders;
- (k) a reference to the words 'such as', 'including', 'particularly' and similar expressions is to be construed without limitation;
- (l) a construction that would promote the purpose - or object - underlying these Conditions (whether expressly stated or not) will be preferred to a construction that would not promote that purpose or object;
- (m) material not forming part of these Conditions may be considered to:
 - (i) confirm the meaning of a clause is the ordinary meaning conveyed by the text of the clause, taking into account its context in these Conditions and the ACCC's Determination A91470 & A91471; or
 - (ii) determine the meaning of the clause when the ordinary meaning conveyed by the text of the clause, taking into account its context in these Conditions and the purpose or object underlying these Conditions, leads to a result that does not promote the purpose or object underlying these Conditions;
- (n) in determining whether consideration should be given to any material in accordance with paragraph (m), or in considering any weight to be given to any such material, regard must be had, in addition to any other relevant matters, to the effect that reliance on the ordinary meaning conveyed by the text of the clause would, have (taking into account its context in these Conditions and whether that meaning promotes the purpose or object of these Conditions).

- (o) the ACCC may authorise the ACCC Adjudication Committee, a member of the ACCC or a member of the ACCC staff, to exercise a decision making function under these Conditions on its behalf and that authorisation may be subject to any conditions which the ACCC may impose;
- (p) in performing its obligations under these Conditions, the Applicants will do everything reasonably within their power to ensure that their performance of those obligations is done in a manner which is consistent with promoting the purpose and object of these Conditions;
- (q) a reference to:
 - (i) a thing (including, but not limited to, a chose in action or other right) includes a part of that thing;
 - (ii) a party includes its successors and permitted assigns; and
 - (iii) a monetary amount is in Australian dollars.

SCHEDULE A – SCHEDULING SEASON BASE YEAR SEAT CAPACITY³⁷

The **Scheduling Season Base Year Seat Capacity** means the Applicants' combined total number of seats flown on the relevant Routes in, as applicable, the NS Season or the NW Season in the Base Year as set out in this Schedule A. In the below tables, references to seat capacity figures for a particular Route are for information purposes only.

Scheduling Season Base Year Seat Capacity for NS Season:

<u>Shanghai-Sydney</u>	<u>Seat Capacity for NS Season</u>
Qantas	121,627 (provisional)
China Eastern	111,341 (provisional)
<i>Total</i>	<i>Total 232,968</i>
<u>Shanghai-Melbourne</u>	<u>Seat Capacity for NS Season</u>
Qantas	0 (provisional)
China Eastern	103,301 (provisional)
<i>Total</i>	<i>Total 103,301</i>
TOTAL SCHEDULING SEASON BASE YEAR SEAT CAPACITY FOR NS SEASON	336,269

Scheduling Season Base Year Seat Capacity for NW Season:

<u>Shanghai-Sydney</u>	<u>Seat Capacity for NW Season</u>
Qantas	88,934
China Eastern	103,922
<i>Total</i>	<i>Total 192,856</i>
<u>Shanghai-Melbourne</u>	<u>Seat Capacity for NW Season</u>
Qantas	0
China Eastern	102,580
<i>Total</i>	<i>Total 102,580</i>
<u>Shanghai-Cairns</u>	<u>Seat Capacity for NW Season</u>
Qantas	0
China Eastern	28,206
<i>Total</i>	<i>Total 28,206</i>
TOTAL SCHEDULING SEASON BASE YEAR SEAT CAPACITY FOR NW SEASON	323,642

³⁷ Note: For the avoidance of doubt, the above figures include both inbound and outbound seat capacity for each relevant Route. This data includes all seats flown on the relevant Routes. It therefore includes seats occupied by uplift/discharge passengers, seats occupied by transit passengers and unoccupied seats.

SCHEDULE B – PROPOSED INDEPENDENT AUDITOR APPOINTMENT

This form sets out the information required by the ACCC in relation to proposed appointment of an independent auditor.

Please note in relation to information given pursuant to this form, giving false or misleading information is a serious offence.

Method of Delivery to the ACCC

The completed Proposed Independent Auditor Appointment form, along with the additional requested information is to be provided to the ACCC to the below email addresses:

1) mergers@acc.gov.au
Attention: Executive General Manager
Merger and Authorisation Review Division

2) **With a copy sent to:**
mergersucu@acc.gov.au
Attention: Director
Undertakings Compliance Unit
Coordination and Strategy Branch
Merger and Authorisation Review Division

Information Required

The ACCC requires the following information in order to assess a Proposed Independent Auditor.

- 1) Proposed Independent Auditor Details:
 - (a) the name of the Proposed Independent Auditor; and
 - (b) the name of the Proposed Independent Auditor's employer and contact details including:
 - Address;
 - Contact name;
 - Telephone number;
 - Other contact details.
- 2) A submission containing the following information:

- (a) details of the Proposed Independent Auditor's qualifications and experience relevant to his or her proposed role pursuant to the Undertaking.
- (b) the names of the owner/s and the directors of [the Proposed Independent Auditor's employer.
- (c) details of any of the following types of relationships between the Applicants and the Proposed Independent Auditor or the Proposed Independent Auditor's employer or confirmation that no such relationship exists whether within Australia or outside of Australia:
 - (i) an Applicant and the Proposed Independent Auditor's employer are Associated Entities.
 - (ii) an Applicant is an Entity Connected with the Proposed Independent Auditor's employer.
 - (iii) The Proposed Independent Auditor's employer is an Entity Connected with an Applicant.
 - (iv) an Applicant and the Proposed Independent Auditor's employer are Related Entities.
 - (v) an Applicant and the Proposed Independent Auditor's employer are Related Parties.
 - (vi) any Related Party, Related Entity or Entity Connected with an Applicant is a Related Party, Related Entity or Entity Connected with the Proposed Independent Auditor.
 - (vii) an Applicant and the Proposed Independent Auditor or the Proposed Independent Auditor's employer have a contractual relationship or had one within the past three years, other than those attached to this form.
 - (viii) the Proposed Independent Auditor's employer is a supplier of an Applicant or has been in the past three years.
 - (ix) an Applicant is a supplier of the Proposed Independent Auditor's employer or has been in the past three years.
 - (x) any other relationship between an Applicant and the Proposed Independent Auditor or the Proposed Independent Auditor's employer that allows one to affect the business decisions of the other.
- 3) A document outlining the terms of appointment for the Proposed Independent Auditor.
- 4) A finalised draft audit plan, drafted by the Proposed Independent Auditor and outlining (to the extent possible) the Proposed Independent Auditor's plans in regard to the establishment audit and the Audit Report.