



Australian
Competition &
Consumer
Commission

Draft Determination

Applications for authorisation

lodged by

Qantas Airways Limited and China Eastern Airlines
Corporation Limited

in respect of

a Joint Coordination Agreement

Date: 24 March 2015

Authorisation numbers: A91470 & A91471

Commissioners:

Sims
Rickard
Schaper
Cifuentes
Court
Featherston
Walker

Summary

The ACCC proposes to deny 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.

The ACCC will seek submissions in relation to this draft determination before making its final decision.

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, with the intention of implementing the Coordination Agreement in June 2015.

The Applicants submit that neither of them can effectively and efficiently serve the Australia – China market alone. Qantas states that it needs a Chinese partner to most effectively provide a seamless customer proposition throughout China and to better align its product offering to demand characteristics in China, in particular to China's predominantly leisure-oriented passenger base. Qantas further states that it wants to improve Shanghai's appeal as a gateway to mainland China by generating improved connectivity and an expanded range of destinations made possible through co-location in China Eastern's terminal in Shanghai.

China Eastern submits that it needs an Australian partner to provide enhanced sales and distribution capability within Australia, as well as additional product and service expertise, in order to attract and retain increased numbers of passengers.

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. The ACCC also understands Qantas' desire to form an alliance with a Chinese airline to establish a gateway to North East Asia. The

ACCC considers that the Proposed Conduct will assist in achieving this. However, the ACCC is concerned that Qantas has chosen to form an alliance with its main competitor on the one route between Australia and China on which Qantas operates direct flights. The ACCC considers that the lessening of competition on this route that will arise as a result of the Proposed Conduct is likely to outweigh any of the public benefits likely to arise from the Proposed Conduct.

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 24% 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 substantial.

Qantas and China Eastern had a combined share of capacity (seats flown) on the Sydney – Shanghai route of 83% over the 12-month period from October 2013 to September 2014 (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 on this route 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.

Some passengers traveling on the Sydney – Shanghai route will have an ultimate destination elsewhere in China. For these passengers, traveling with another airline that has a hub in a city other than Shanghai may be a viable alternative to the service offered by the Applicants. However, the information available to the ACCC shows that Sydney – Shanghai is a strong point to point route and other one-stop routes offered by other airlines are unlikely to offer a strong competitive constraint.

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.

Therefore, the ACCC considers that Qantas and China Eastern are the major carriers on the Sydney – Shanghai route and each other’s closest competitors. The competitive constraint they impose on each other is likely to be lost if the Proposed Conduct proceeds.

For these reasons the ACCC considers that the Proposed Conduct is likely to result in significant public detriment. It is likely to give Qantas and China Eastern an increased ability and incentive to unilaterally reduce capacity, or limit growth in capacity, relative to that which would occur in the absence of the Proposed Conduct, thereby allowing the Applicants to increase airfares on the Sydney – Shanghai route.

Public benefits

The ACCC accepts that the Coordination Agreement may produce benefits for the Applicants. In particular, the ACCC notes that the Proposed Conduct provides an opportunity for Qantas, by aligning with China Eastern, to expand its product offering in North East Asia and that this represents a significant private benefit to Qantas. However, the ACCC considers that the magnitude of the benefits accruing to the traveling public more broadly as a result of the Proposed Conduct is likely to be limited.

This is partly because Qantas and China Eastern have an existing codeshare arrangement under which Qantas already codeshares on China Eastern flights between Melbourne and Shanghai, between Sydney and Beijing (via Nanjing) and between Singapore and Shanghai. Qantas also codeshares on various China Eastern services within mainland China. China Eastern codeshares on Qantas’ services between Sydney and Shanghai and between Singapore and Sydney/Melbourne/Brisbane, as well as on various Qantas trans-Tasman and domestic services within Australia. Qantas passengers are also already able to earn and redeem frequent flyer points on eligible China Eastern flights.

The ACCC considers that if the Proposed Conduct does not proceed, the existing codeshare arrangement between Qantas and China Eastern 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.

One additional benefit of the proposed Coordination Agreement that the ACCC does recognise is that it will enable Qantas to co-locate at China Eastern’s terminal in Shanghai. This will 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, the ACCC does not consider that this automatically means that the Proposed Conduct will increase the range of travel options available to passengers for beyond travel from Shanghai. Passengers who value connectivity and convenience 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 improved connectivity and convenience as a result of the Proposed Conduct is a public benefit. However, this public benefit 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.

More broadly, whilst the argument has not been submitted by the Applicants, the Proposed Conduct may provide improved opportunities and incentives for the Applicants to extend the domestic routes covered by their existing codeshare

arrangements. 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 codeshare agreement.

The ACCC also considers that the Proposed Conduct is likely to result in some public benefits through:

- a) allowing the Applicants to coordinate flight schedules on the Sydney – Shanghai route and thereby spread departure times, providing greater choice for some passengers
- b) potentially enhancing the attractiveness of the Applicants' loyalty programs, and
- c) 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 considers that it is possible that the Proposed Conduct will assist in the facilitation of the addition of more frequencies and destinations between China and Australia by the Applicants. However, the Applicants have not provided any information or evidence in support of these claims. Therefore, while this is a potential source of public benefit, the ACCC does not have sufficient evidence to conclude that it is likely to occur.

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 factors which influence tourism and trade, and the ACCC's conclusion that the Proposed Conduct is likely to provide the Applicants with an increased ability and incentive to raise airfares on the Sydney – Shanghai route, the ACCC considers the impact of the Proposed Conduct on tourism and trade is likely to be small.

Balance of public benefit and detriment

The ACCC considers that the Proposed Conduct is likely to result in a range of public benefits. However, the ACCC considers that the magnitude of these benefits is likely to be limited.

The ACCC considers that on the Sydney – Shanghai route the extent of the reduction in competition, and associated public detriment, is likely to be significant and outweigh any benefits of the Proposed Conduct. The ACCC considers that Qantas and China Eastern are the main alternative services on this route and each other's closest competitors. The competitive constraint that each imposes on the other on the route is likely to be greatly reduced if the Proposed Conduct proceeds.

On balance, the ACCC considers that the likely public benefit from the Proposed Conduct does not outweigh the likely public detriment. Therefore, the ACCC proposes to deny authorisation to Qantas and China Eastern's Coordination Agreement.

The ACCC will seek submissions in relation to this draft determination before making its final decision.

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Abbreviations

ACCC	Australian Competition and Consumer Commission
Act	<i>Competition and Consumer Act 2010</i> (Cth)
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
China Eastern	China Eastern Airways 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
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:
 - a) an alliance with Emirates, which was authorised by the ACCC on 27 March 2013
 - b) an alliance with American Airlines pursuant to a Joint Business Agreement which was authorised by the ACCC on 29 September 2011 and
 - c) 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.
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

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

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 (**CEAHC**), founded in 1996, is a state-owned enterprise incorporated in China and the parent company of China Eastern, with a shareholding of 64.36%. 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:
 - a) improving schedules, frequencies and connection times
 - b) enabling the expansion of destinations served by their operations
 - c) expanding connecting services at primary gateways leading to more one-stop online points of service
 - d) developing new fare products and promotions
 - e) improving coordination of use of airport facilities by expanding reciprocal airport lounge access, improving facilities within lounges and streamlining check-in facilities for passengers
 - f) co-locating their operations in Terminal 1 at Shanghai Pudong airport
 - g) 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
 - h) increasing the international competitiveness of both Applicants
 - i) easing planning itineraries through the provision of better information to agents, and

- j) improving reciprocal inventory access to facilitate more bookings on both Applicants' services, including group bookings.
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, with the intention of implementing the Coordination Agreement in June 2015.

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 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.
19. 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.

20. 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

21. 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.
22. International air transport services between two countries must be specifically authorised pursuant to bilateral air services arrangements.
23. 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 2011.²
24. 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 2015.³ The new rights were available to airlines from 21 January 2015.
25. Prior to 21 January 2015, the designated capacity for airlines in each country was:
 - a) a total of 22,500 seats each way per week to and from Sydney, Melbourne (including Avalon), Brisbane and Perth (the Australian Major Gateways) and
 - b) unrestricted capacity, frequency and aircraft type to and from all points in Australia other than the Australian Major Gateways.
26. The designated airlines of Australia and China could also operate in any direction an additional 2,500 weekly seats between points in China and the Australian Major Gateways, provided such services operate via or beyond to a point in Australia other than an Australian Major Gateway.
27. In Australia capacity entitlements are allocated by the International Air Services Commission (**IASC**). Qantas currently has 4,471⁴ seats allocated to it and is currently the only Australian airline allocated capacity on routes to China.

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

³ 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.

⁴ International Air Services Commission, 16 December 2014 submission, p 2.

28. In China capacity entitlements are allocated by the CAAC. All 22,500 seats available to Chinese carriers prior to 21 January 2015 have been allocated.⁵
29. 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 current capacity entitlements on the Shanghai – Sydney and Shanghai – Melbourne routes.
30. Under the revised air services arrangements, from 21 January 2015 the following capacity entitlements are available:
 - a) 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.
 - b) 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:
 - 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.
31. 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.
32. As under the previous arrangements, 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.

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

⁵ Productivity Commission research project – Australia's international tourism industry: trends, drivers and barriers to growth. Department of Infrastructure and Regional Development submission 4/12/14, Attachment A. <http://www.pc.gov.au/research/completed/international-tourism/comments/submissions/submission-counter/sub022-international-tourism-attachment.pdf>

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:
- a) Qantas operates a daily service between Sydney and Shanghai (China Eastern codeshares on this service)
 - b) 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)
 - c) China Eastern operates a three times per week service between Sydney and Beijing (via Nanjing) (Qantas codeshares on this service), and
 - d) China Eastern operates a direct seasonal service between Cairns and Shanghai.
35. Current indirect services between China and Australia offered by the Applicants include:
- a) Qantas operates services from Melbourne/Brisbane/Sydney to Singapore (China Eastern codeshares on these services) and
 - b) 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. Accordingly, Jetstar offers one stop services via Singapore between:
- a) Melbourne – Hangzhou
 - b) Darwin – Shantou
 - c) Perth – Haikou, Hangzhou and Shantou.⁶

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 Singapore. 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% 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.

37. 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

38. Qantas and China Eastern entered into a codeshare agreement in July 2008 (the Codeshare Agreement). The Codeshare Agreement, as subsequently amended 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.
39. 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
40. 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

41. 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
42. 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.
43. 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.

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

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.

Other airlines operating between Australia and China

44. Other than Qantas and China Eastern, the main carriers servicing Australia-China, operating direct and/or indirect routes, include:

- a) China Southern – China Southern operates twice daily services between Guangzhou and Sydney, up to two daily services from Melbourne, up to daily services from Brisbane and three services per week from Perth. China Southern also operates nine daily services from Guangzhou to Shanghai. China Southern is the largest Chinese airline by capacity, fleet and passengers flown.⁸

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

- b) Air China – Air China operates services to Beijing from Sydney up to seven times a week and from Melbourne five times a week. It also operates services to Sydney from Shanghai three times a week and Melbourne five times a week.⁹

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.

- c) Cathay Pacific – Cathay Pacific operates services to Hong Kong, with connections to mainland China, from Sydney, Melbourne, Brisbane, Adelaide, Cairns and Perth. It operates 78 return frequencies weekly between Australia and Hong Kong, with Cathay/Dragonair having 433 return frequencies weekly from Hong Kong to mainland China.¹⁰ Cathay Pacific operates 17 flights a day between Hong Kong and Shanghai.

- d) Sichuan Airlines – Sichuan Airlines operates services three times a week from Melbourne to Chengdu and two times a week from Sydney to Chongqing.¹¹ It is based in Chengdu and serves more than 80 cities in China.

- e) Singapore Airlines – Singapore Airlines operates four 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. It operates 113 return frequencies weekly in total to Singapore from Australia, with 56 return frequencies weekly from Singapore to China.¹² Singapore Airlines' subsidiary Tiger Airways operates services from

⁸ Qantas and China Eastern, submission in support of applications for authorisation A91470 & A91471 lodged 18 November 2014, p 21.

⁹ Qantas and China Eastern, submission in support of applications for authorisation A91470 & A91471 lodged 18 November 2014, p 22.

¹⁰ Qantas and China Eastern, submission in support of applications for authorisation A91470 & A91471 lodged 18 November 2014, p 20.

¹¹ Qantas and China Eastern, submission in support of applications for authorisation A91470 & A91471 lodged 18 November 2014, p 22.

¹² Qantas and China Eastern, submission in support of applications for authorisation A91470 & A91471 lodged 18 November 2014, p 21, 23.

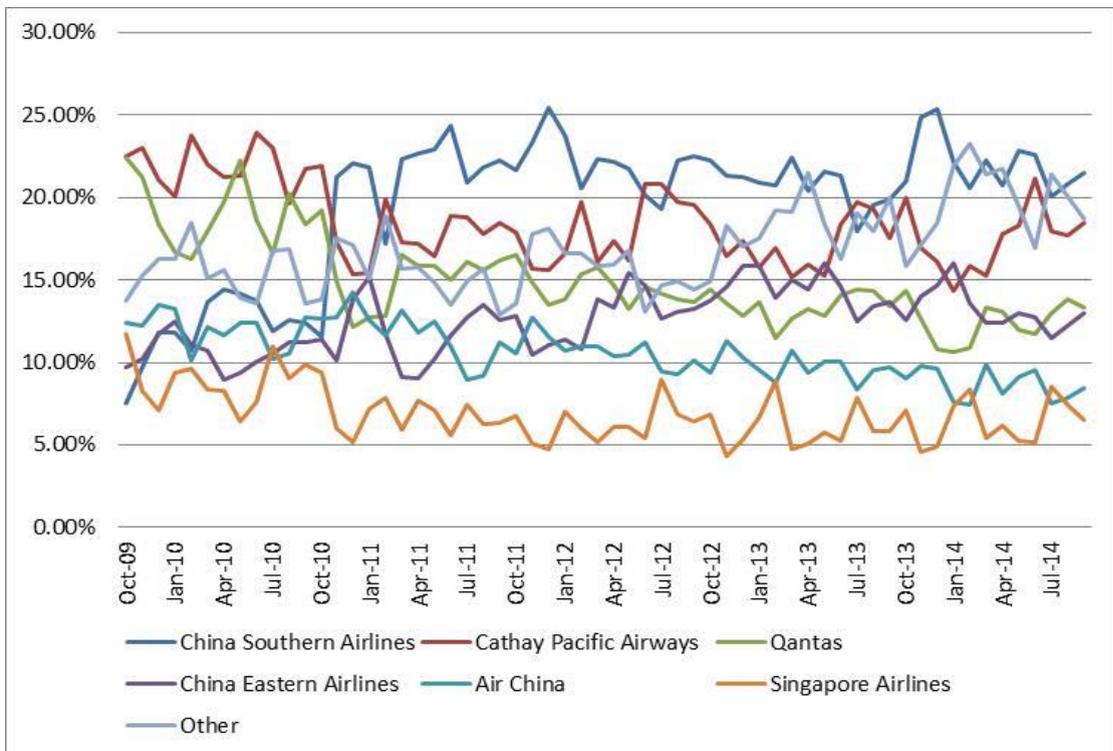
Perth to Singapore and on to regional destinations in South East Asia, including China.

- f) 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, it operates 72 return frequencies weekly to Kuala Lumpur, with 40 return frequencies weekly from Kuala Lumpur to China.¹³

Air passenger travel between Australia and China

- 45. 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.
- 46. There were around 1,050,000 seats and around 830,000 passengers flown (each way) on direct flights between Australia and China in 2014 (calendar year). This compares to around 501,000 seats and 405,000 passengers in 2010.
- 47. Inclusive of indirect flights, for the year ending September 2014 Qantas and China Eastern had a combined share of passengers flown between Australia and China of around 26% (12.4% for Qantas and 13.2% for China Eastern). This compares to other major airlines China Southern – 22%, Cathay Pacific – 17.3%, Air China – 8.6% and Singapore Airlines – 6.5%.

Graph 1: Share of total passengers Australia – China¹⁴



¹³ Qantas and China Eastern, submission in support of applications for authorisation A91470 & A91471 lodged 18 November 2014, p 21.

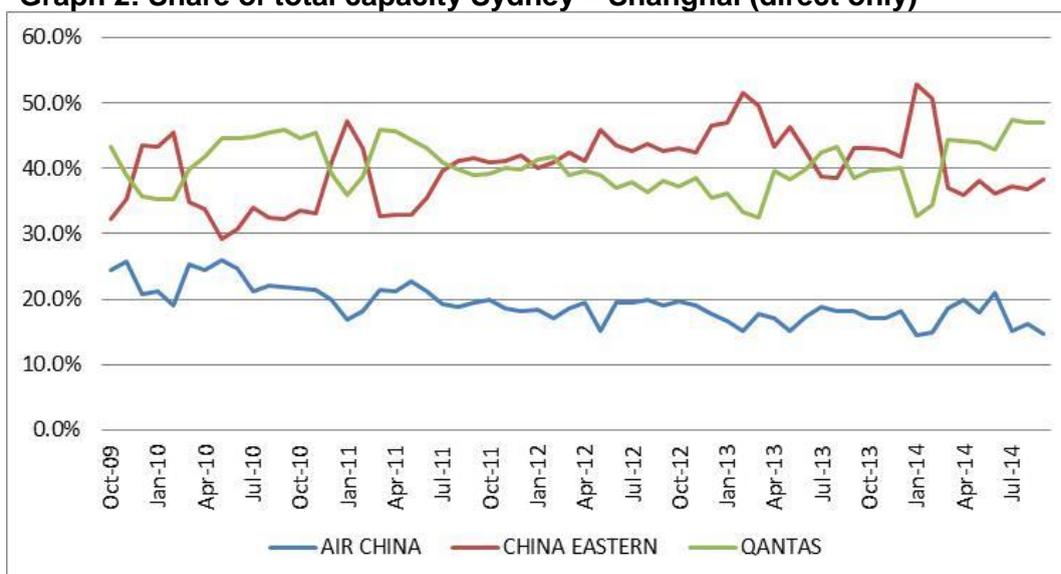
¹⁴ ACCC calculations based on passenger card data provided by the Bureau of Infrastructure, Transport and Regional Economics.

48. Around 80% of passenger arrivals in Australia from China on direct flights come from Shanghai and Guangzhou. Over the five years ending September 2014 the share of travellers departing from Shanghai has substantially decreased (from around 54% to around 37%) while the share of travellers departing from Guangzhou has significantly increased (from around 26% to over 40%). 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 between 2009 and 2011. From 2012 until September 2014 both departure points' share of Australian arrivals have been more stable compared to the preceding two years, although Shanghai's share continues to fall. 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 September 2014 but not at the same rate as traffic from Guangzhou. There was a small drop in passenger traffic from Shanghai in the year ending September 2014.

Air passenger travel between Sydney and Shanghai

49. In terms of their own metal operations between Australia and China, the Applicants only overlap on the Sydney – Shanghai route.
50. 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.
51. Total seats flown on the route in 2014 were around 255,000 (each way, direct flights).¹⁵ This represents around 24% of all seats flown between Australia and China on direct flights.
52. For the year ending September 2014, Qantas and China Eastern had a combined share of capacity on the route of 83% (direct flights). This compares with a combined share of capacity of 77% in the year ending September 2010. Over the same period Air China's share of capacity has fallen from 23% to 17%.

Graph 2: Share of total capacity Sydney – Shanghai (direct only)¹⁶

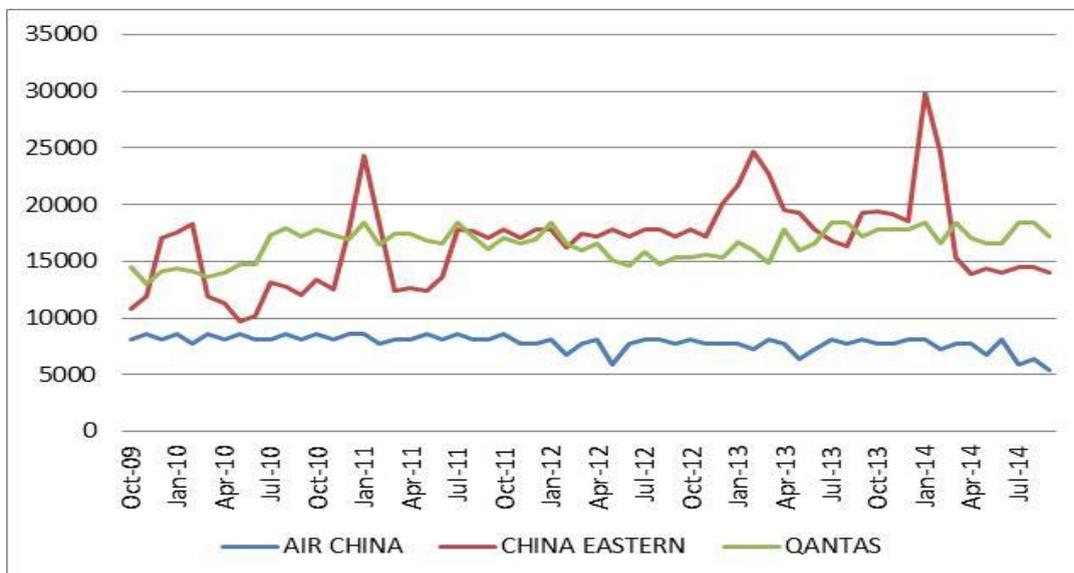


¹⁵ This figure includes Air China Sydney-Shanghai-Beijing flights.

¹⁶ ACCC calculations based on information provided by the Bureau of Infrastructure, Transport and Regional Economics.

53. Between the year ended September 2010 and the year ended September 2014 seats flown on the route increased by 17%. Seats flown by Air China decreased by 13% and seats flown by China Eastern and Qantas increased by 35% and 18% respectively.

Graph 3: Total capacity Sydney – Shanghai (direct only)¹⁷



54. As well as direct flights operated by the Applicants and Air China, a number of indirect services are also offered. In particular, Air China also operates an indirect service via Beijing two to four times a week (depending on the season). Other 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.
55. Cathay Pacific flights via Hong Kong (12:35 to 13:10 hours) and China Southern flights via Guangzhou (13:20 to 14:05 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.
56. 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.¹⁸

¹⁷ ACCC calculations based on information provided by the Bureau of Infrastructure, Transport and Regional Economics.

¹⁸ 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.¹⁹

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

57. 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.
58. Qantas submitted that the MIDT data understates the real shares of indirect operators because the MIDT data:
- a) only captures bookings made with travel agents through the global distribution systems and attempts to estimate the number of bookings made directly with airlines
 - b) 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
 - c) 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
 - d) 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

¹⁹ 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.

- e) does not capture passengers who fly to an alternative airport within the broader Shanghai catchment area.

59. 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.²⁰ 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).
60. 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.
61. 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.
62. 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.
63. 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.
64. 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.

²⁰ Qantas used a different set of MIDT data to that noted at paragraph 56. 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).

65. 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 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

66. Qantas operates the following dedicated freighter services, in addition to freight carried in bellyspace of passenger aircraft:
- a) from Sydney to Shanghai (via Bangkok and onwards to the US), twice weekly
 - b) from Sydney to Shanghai (via Chongqing and onwards to the US), weekly
 - c) from Sydney to Shanghai (onwards to the US), weekly
 - d) from Sydney to Shanghai direct twice weekly and
 - e) from Shanghai to Sydney direct, weekly.
67. China Eastern carries freight in the bellyspace of its passenger services but does not operate any dedicated freighters to or from Australia.
68. 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.
69. In relation to freight, data provided by BITRE indicates that during in 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%.
70. 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

71. The ACCC tests the claims made by an applicant in support of its application for authorisation through an open and transparent public consultation process.
72. The ACCC invited submissions from a range of potentially interested parties including competitors, airports, regulators, relevant government agencies, industry groups and service suppliers.²¹ In response, the ACCC received ten submissions either neutral, expressing qualified support or in support of the applications and one submission opposing the applications.
73. 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.
74. 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.
75. 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.
76. Jumpjet Airlines Limited expressed concerns that the alliance will inhibit the entry and expansion of domestic Australian airlines.

²¹ A list of the parties consulted and the public submissions received is available from the ACCC's public register www.accc.gov.au/authorisationsregister.

ACCC assessment

77. The ACCC's assessment of the Proposed Conduct is carried out in accordance with the relevant net public benefit tests²² 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

78. The Applicants submit 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 submit 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.
79. 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 submit that the appropriate markets are:
- a) the market for passenger air services between Australia and China and
 - b) the market for freight air services between Australia and Asia.
80. The ACCC considers that the relevant areas of competition for the purposes of this assessment are:
- a) international air passenger transport services between Australia and China
 - b) international air cargo transport services (freight and mail) between Australia and China and
 - c) 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

81. 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.
82. Within this area of competition, the ACCC considers that it is appropriate to examine the likely effects of the proposed alliance on competition and rivalry on particular routes where necessary. In this instance, specifically the Sydney –

²² Subsections 90(5B), 90(7) and 90(8).

Shanghai route being the one route on which the Applicants overlap with direct flights.

83. 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.
84. 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

85. 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:
- a) 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
 - b) 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

86. 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.
87. No interested party has identified any impacts arising from the Applicants undertaking procurement jointly in the future.

88. 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.
89. The ACCC has also had regard to:
- a) the relatively large number of alternative acquirers of these products
 - b) the fact that many of the inputs are acquired on an international basis and
 - c) China Eastern being a relatively small acquirer of these services in Australia.
90. 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 draft determination.

Future with and without

91. 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.
92. The Applicants submit 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.
93. 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:
- a) the Applicants will have very little commercial incentive to co-locate terminals at Shanghai Pudong Airport

- b) 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
 - c) Qantas would be unlikely to form an alliance with an alternative North East Asian carrier.
94. 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 19% to 12% in the five years to September 2014. 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 September 2014. More broadly, Qantas passenger numbers between Australia and China have grown by a small amount between 2010 and 2014.
95. 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.
96. 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 18% between the year ended September 2010 and the year ended September 2014.
97. 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.
98. 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

99. 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.²³

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

Public benefits arising from airline alliances

101. 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.

102. It is widely recognised that the realisation of potential public benefits from airline alliances depends on:

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

103. 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.

²³ *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.

104. 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%.
105. The ACCC has had regard to the airlines' complementarity in assessing the public benefits (and public detriments) of the Proposed Conduct below.
106. 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 may be more closely aligned under the Proposed Conduct than under the existing codeshare agreement.
107. 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

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

- g) promote increased tourism in Australia, increased employment in Australia and enhanced international trade opportunities for Australian businesses and
- h) expedite the growth of China Eastern in Australia, leading to further employment in Australia and other economic benefits.

109. 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

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

111. 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.

112. 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.

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

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

Enhanced products and services

114. When airlines that provide complementary services act independently or less co-operatively, 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'²⁴ 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.

²⁴ 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.

115. 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.
116. 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 some public benefits.
117. 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:
 - a) increased connectivity
 - b) better schedule spread
 - c) improved loyalty program benefits and
 - d) new frequencies and destinations.

Increased connectivity and convenience

118. The Applicants submit 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.
119. 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.
120. 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.
121. 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.
122. 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.

123. 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.
124. It follows therefore, that the Proposed Conduct 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. While this will improve the attractiveness of Qantas services for passengers who wish to travel beyond Shanghai, having regard to existing options for such travellers, the extent of the additional benefit of this type to the public from the Proposed Conduct is limited.
125. More generally, the Applicants have not specifically argued that the Proposed Conduct will improve connectivity of their services other than in relation to Qantas passengers transiting through Shanghai. However, as discussed above, the ACCC considers that allowing the Applicants to coordinate scheduling is likely to enable better scheduling of complementary services, thereby facilitating greater connectivity between their services. 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.

Better schedule spread

126. 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.
127. The Applicants submit 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.
128. For example, currently, Qantas and China Eastern flights from Sydney to Shanghai depart at 10:50 and 12:00 respectively. Return flights from Shanghai depart at 20:05 and 20:20. Under the proposed alliance, the Applicants submit 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 argue that this will provide customers with greater choice and flexibility of flight times.
129. 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.

130. 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.
131. 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.

Improved loyalty program benefits

132. 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.
133. 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.
134. The Applicants argue 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 submit 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.
135. 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.
136. 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 did not provide further details of these benefits.
137. 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. 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.

138. Further, there may be more opportunities for the additional initiatives noted at paragraphs 134 and 136 to be implemented under the Proposed Conduct. While such initiatives could be adopted under the existing codeshare agreement, as discussed at paragraphs 114 to 116, the ACCC considers that the Applicants' incentives to do so may be stronger under the Proposed Conduct.

New frequencies and destinations

139. There has been substantial analysis undertaken about the relationship between airlines' product and service quality and passenger demand.²⁵

140. 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.

141. The Applicants submit that by being able to combine load volumes, they expect 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 Shanghai²⁶ and 7 return services per week between Melbourne and Shanghai²⁷ based on the Northern Winter 2014 Schedule). They also submit that the alliance will provide the basis for the Applicants to explore opportunities to introduce new services between Brisbane and/or Perth and Shanghai.

142. The ACCC considers 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. This could be further enhanced if the Applicants were to undertake joint marketing initiatives which could potentially stimulate additional passenger traffic. The ACCC also recognises 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.

143. However, the Applicants have 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 have made general assertions about increases in frequencies without any supporting material.

²⁵ 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', *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.

²⁶ 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.

²⁷ China Eastern operated an additional daily flight each way on the Melbourne – Shanghai route between 30 November 2014 and 9 March 2015.

144. Further, with respect to the Sydney – Shanghai route, as discussed in the ACCC’s assessment of the public detriments of the Proposed Conduct, the ACCC considers the Coordination Agreement 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.
145. Therefore, while the ACCC considers that 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 have not provided sufficient evidence for the ACCC to conclude that this is a likely, as opposed to a possible, outcome from the Proposed Conduct.

Cost savings and other efficiencies

146. 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.
147. 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.
148. 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.
149. 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.
150. 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.
151. 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 148 and 149 (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.

Triggering a competitive response from rivals

152. The Applicants submit that the alliance will benefit consumers by provoking competitive fares, products and service offerings from rival carriers. In particular, the Applicants submit that they expect a swift reaction from competitors, particularly China Southern and Air China. The Applicants submit that the proposed alliance will also increase competition between Asian hubs.
153. 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.
154. The ACCC considers that these reflect existing competition between airlines on routes between Australia and China. Further, the ACCC notes that examples cited by Qantas broadly coincide with the announcements of the increased capacity entitlements for airlines operating between Australia and China and the signing of a Free Trade Agreement between Australia and China (FTA). In addition, most of the examples were in relation to routes on which Qantas and China Eastern do not offer direct flights and none of them were in relation to the Sydney – Shanghai route. There is no evidence to suggest that decisions to add any of these services were influenced by the announcement of the Proposed Conduct.
155. As outlined above, the ACCC considers that the alliance is likely to enhance the Applicants' product and service offering and this has the potential to trigger a competitive response from rival airlines. However, regard must be had to the varying competitive conditions across the relevant markets. The extent of any competitive response on Australia – China routes, and in particular on the Sydney – Shanghai route, is unclear particularly given the ACCC's conclusion, discussed below, about the lack of competitive constraints on the Applicants on the Sydney – Shanghai route.
156. On balance, the ACCC does not consider there to be sufficient evidence to conclude that a public benefit, in the form of triggering a competitive response from rivals, is likely to arise.

Stimulation of tourism and trade

157. A number of interested parties support the alliance on the basis that it will have benefits for Australian trade and tourism. The National Tourism Alliance, Austrade, Tourism Victoria, Cairns Airport, Perth Airport and Melbourne Airport 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

158. The Applicants submit 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 state 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.

159. 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.
160. The ACCC recognises that promotion of Australia as a tourist destination has public good characteristics.²⁸ 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.
161. 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.
162. 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.
163. In this case, the ACCC notes that a variety of factors, including initiatives such as the Australian Government's Asia Marketing Fund²⁹ and Tourism Australia's Key Distribution Partner Program³⁰, are likely to influence inbound tourism demand.
164. 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.

²⁸ 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.

²⁹ 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.

³⁰ 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.

165. In addition, if the Proposed Conduct does provide the Applicants with an increased ability to increase airfares on the Sydney – Shanghai route, as the ACCC has concluded in its assessment of the public detriments of the Proposed Conduct is likely, this could have a negative impact on tourism. Any broader impact of the Proposed Conduct on demand for tourism in Australia must be weighed against this.
166. Therefore, while the Applicants' improved product and service offering under the Proposed Conduct has the potential to promote tourism to Australia to an extent, based on the evidence before it the ACCC considers that any net positive impact on tourism as a result of the Proposed Conduct is likely to be small.

Trade

167. The Applicants submit 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.³¹
168. The Applicant's also submit 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 note statements by the Department of Foreign Affairs and Trade that concluding the FTA will provide extensive opportunities to Australian businesses, removing barriers to trade with Australia's biggest market for services, resources and agriculture.
169. 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.
170. 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.
171. 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.
172. Further, as discussed in relation to tourism at paragraph 164, incentives to undertake investment or develop initiatives that will promote trade will not be as strong when the proposed alliance is not metal neutral. As also noted at paragraph 165, to the extent that the Proposed Conduct results in increased fares on the Sydney – Shanghai route, this could negatively impact trade between Australia and China.
173. Therefore, the ACCC considers that any net positive impact on trade as a result of the Proposed Conduct is likely to be small.

³¹ 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.

174. The ACCC also considers that any trade-related benefits resulting from the FTA are not attributable to the Proposed Conduct.

Enhanced and expedited growth in Australia by China Eastern

175. 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).

176. 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.

177. 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.

178. Further, as discussed above in relation to new frequencies and destinations, the Applicants have not provided information to substantiate their claims about expedited growth in Australia by China Eastern.

ACCC conclusion on public benefits

179. 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. However, the Proposed Conduct is unlikely to increase the range of travel options available to passengers for beyond travel from Shanghai. Therefore this public benefit is only likely to accrue 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.

180. 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.

181. The ACCC considers that the Proposed Conduct would also be likely to result in some public benefits through:

- a) allowing the Applicants to coordinate flight schedules on the Sydney – Shanghai route and thereby spread departure times, providing greater choice for some passengers

- b) potentially enhancing the attractiveness of the Applicants' loyalty programs and
- c) 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.

182. The ACCC also recognises that the Proposed Conduct has the potential to result in some small public benefit in the form of promotion of tourism and trade between Australia and China. However, given the wide range of factors which influence tourism and trade, and the ACCC's conclusion that the Proposed Conduct is likely to provide the Applicants with an increased ability and incentive to raise airfares on the Sydney – Shanghai route, the ACCC considers the net impact of the Proposed Conduct on tourism and trade is likely to be small.

Public detriment

183. 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.³²

184. 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 Proposed Conduct is likely to result in significant public detriment by giving Qantas and China Eastern an increased ability and incentive to unilaterally reduce capacity, or limit growth in capacity, to increase air fares.

185. 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 80.

186. 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.

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

The Sydney – Shanghai route – unilateral effects

188. 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

³² *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

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.

189. 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 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.
190. 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.
191. In assessing the likelihood that an alliance would find it profitable to unilaterally reduce or limit growth in capacity, the ACCC has considered:
 - a) the alliance’s share of capacity (number of seats) and passengers
 - b) whether the services of the alliance partners are close substitutes
 - c) the competitive constraint imposed by other airlines and
 - d) 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).

The alliance’s share of capacity and passengers

192. The shares of capacity on the Sydney – Shanghai route (direct only) are shown on the graph at paragraph 52. The graph illustrates that Qantas and China Eastern had a combined share of capacity on the Sydney – Shanghai route of 83% (direct flights) for the year ending September 2014. This compares with a combined share of capacity flown of 77% in the year ending September 2010. Over the same period Air China’s share of capacity has fallen from 23% to 17%.
193. Numerous airlines provide indirect flights between Sydney and Shanghai. The MIDT data at paragraph 56 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%.³³
194. 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

195. The Applicants argue that the Proposed Conduct will bring together two complementary networks and business models. The Applicants argue that doing

³³ Qantas has raised concerns with these estimates as discussed at paragraph 57 to 65.

so will result in limited competitive detriment, primarily because operational overlap between the Applicants is limited to one route, Sydney – Shanghai.

196. 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 24% 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.
197. 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.
198. 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% for the year ending September 2014) but each had a similar percentage traveling for holidays (both had 46% in the year ending September 2014). 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%.
199. 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 daily flights from Sydney to Shanghai and Shanghai to Sydney are closely aligned and both fly similar types of aircraft.
200. 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 around 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 17% (as measured on an annual basis). Air China has been reducing capacity on the route while Qantas and China Eastern have been increasing capacity.
201. 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

202. Qantas submits 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 submit that the focus on hub

competition for carriers offering indirect services on the route will impose a competitive constraint.

203. 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 17% share of capacity on the route for the year ended September 2014. This share has fallen from 23% for the year ended September 2010. Similarly, Air China’s total capacity on the route has fallen by 13% over the same period, while China Eastern and Qantas’ capacity have increased by 35% and 18% 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.
204. 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.
205. 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. 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 unprofitable for Qantas and China Eastern. Further, 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.
206. 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.
207. The Applicants argue 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).
208. 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.
209. 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.

210. The ACCC notes that, as discussed at paragraph 83, 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.
211. 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) and China Southern flights via Guangzhou (13:20 to 14:05). On price, Cathay Pacific and China Southern are comparable to, and on occasions significantly cheaper than, direct flights offered by the Applicants.
212. 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).
213. 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.
214. 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.
215. Another relevant consideration is the extent of ‘beyond travel’ by 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 other than Shanghai or Sydney as substitutable for the Sydney – Shanghai service provided by the Applicants.
216. However, 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.
217. 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.

218. Further, some passengers may have continued their travel on a different ticket and/or with another airline.
219. Notwithstanding this, the data provided by Qantas suggests that, at least for Qantas ticketed passengers, Sydney – Shanghai is 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.
220. Further, even if, as submitted by Qantas, the Proposed Conduct increases the number of passengers traveling on Qantas flights who transit through Shanghai to other destinations in China, 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.
221. 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.).
222. 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.

Likelihood of timely entry and expansion

223. The Applicants argue 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.
224. 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.
225. The ACCC notes that none of the examples cited by Qantas were on the Sydney – Shanghai route. Further, for the reasons discussed in paragraphs 209 to 222, 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.
226. 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.

227. 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.
228. 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.
229. As with most international airlines, Chinese airlines base their international operations around their home hubs. For example, China Southern, China Eastern, Air China and Sichuan Airlines direct flights to destinations in Australia all originate from their home hubs. China Eastern and Air China are the only airlines flying international longhaul flights with hubs in Shanghai.
230. 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.
231. 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.
232. In addition, as discussed at paragraphs 21 to 32, the ability for Chinese airlines to offer services to and from Australia is subject to capacity entitlements being allocated by the CAAC. There is very little public information available about the criteria used by the CAAC to allocate capacity. The ACCC notes that all 22,500 seats available to be allocated to Chinese airlines prior to 21 January 2015 for routes including Sydney – Shanghai have been allocated.³⁴ Further, the 11,000 seats of additional capacity progressively becoming available to Chinese airlines between 21 January 2015 and October 2016 for routes including Sydney – Shanghai is to be shared across twelve routes between Australia and China (Guangzhou/Shanghai/Beijing to Sydney/Melbourne/Brisbane/Perth). Some of these routes are currently significantly underserved compared to the Sydney – Shanghai and other major routes between Australia and China.

³⁴ Productivity Commission research project – Australia’s international tourism industry: trends, drivers and barriers to growth. Department of Infrastructure and Regional Development submission 4/12/14, Attachment A. <http://www.pc.gov.au/research/completed/international-tourism/comments/submissions/submission-counter/sub022-international-tourism-attachment.pdf>

The Sydney-Shanghai route – coordinated effects

233. 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.
234. 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.
235. 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

236. 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 83% over the 12-month period from October 2013 to September 2014 (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.
237. 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. For these reasons, the ACCC considers that the Proposed Conduct is likely to result in significant public detriment by giving Qantas and China Eastern an increased ability and incentive to unilaterally reduce capacity, or limit growth in capacity, to increase airfares on the Sydney – Shanghai route.

Other areas of competition potentially affected by the Proposed Conduct

Passenger services on routes other than Sydney – Shanghai

238. 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).
239. 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).

240. As noted at paragraph 35, 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.
241. 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.
242. 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.
243. This means that the Applicants will no longer have the separate inventories of seats on each other's flights noted at paragraph 241 to sell. Further, the Applicants will be able to coordinate their decisions about fares charged by them on the route.
244. 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.
245. 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

246. No interested party commented on the effect of the Proposed Conduct on international air cargo transport services.
247. 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 66 to 70.

248. For the reasons discussed at paragraph 85, 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.
249. 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).
250. 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.
251. 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

252. 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.
253. The ACCC considers that the Proposed Conduct is likely to result in a range of public benefits. However, the ACCC considers that the magnitude of each of these benefits is likely to be limited.
254. Qantas co-locating at China Eastern's terminal in Shanghai will 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, the Proposed Conduct is unlikely to increase the range of travel options available to passengers for beyond travel from Shanghai. Passengers who value connectivity and convenience 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 while the ACCC considers that improved connectivity and convenience as a result of the Proposed Conduct is a public benefit, this public benefit is only likely to accrue to customers who wish to transfer to a China Eastern flight for onward travel in Shanghai and who have a preference to fly with Qantas for the Sydney – Shanghai leg of their journey.
255. More generally, whilst the argument has not been submitted by the Applicants, the Proposed Conduct may provide improved opportunities and incentives for the Applicants to extend the domestic routes covered by their existing codeshare arrangements. 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 codeshare agreement.

256. The ACCC considers that the Proposed Conduct would also be likely to result in some public benefits through:
- a) allowing the Applicants to coordinate flight schedules on the Sydney – Shanghai route and thereby spread departure times, providing greater choice for some passengers
 - b) potentially enhancing the attractiveness of the Applicants' loyalty programs and
 - c) 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.
257. The ACCC also considers that there is some greater prospect of the Applicants adding additional frequencies and destinations between China and Australia under the Proposed Conduct. However, the Applicants have not provided any information or evidence in support of these claims. Therefore, while this is a potential source of public benefit, the ACCC does not have sufficient evidence to conclude that it is likely to occur.
258. 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 factors which influence tourism and trade, and the ACCC's conclusion that the Proposed Conduct is likely to provide the Applicants with an increased ability and incentive to raise airfares on the Sydney – Shanghai route, the ACCC considers the impact of the Proposed Conduct on tourism and trade is likely to be small.
259. 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.
260. 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.
261. 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.
262. Some passengers traveling on the Sydney – Shanghai route will have an ultimate destination elsewhere in China or Australia. For these passengers, traveling with another airline that has a hub in a city other than Shanghai may be a viable alternative to the service offered by the Applicants. However, the information available to the ACCC suggests that Sydney – Shanghai is a strong point to point

route such that other hubs that passengers are able to utilise are unlikely to be a strong competitive constraint for passengers traveling this route.

263. 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.
264. Therefore, the ACCC considers that the Proposed Conduct is likely to result in significant public detriment by giving Qantas and China Eastern an increased ability and incentive to unilaterally reduce capacity, or limit growth in capacity, to increase airfares on the Sydney – Shanghai route.
265. For the reasons outlined in this draft determination the ACCC is not satisfied that the Proposed Conduct is likely result in a public benefit that would outweigh the likely public detriment, including the detriment constituted by any lessening of competition that would be likely to result.

ACCC consideration of conditions of authorisation

266. The CCA permits the ACCC to grant authorisation subject to conditions.³⁵ 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 Act.³⁶
267. 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.³⁷
268. In considering past airline alliances the ACCC has imposed conditions to address concerns that the proposed alliance is likely to provide an increased ability and incentive to unilaterally reduce capacity, or limit growth in capacity, to increase airfares.³⁸
269. Broadly, these conditions, which have been applied to alliances operating on trans-Tasman routes, have required the applicants to at least maintain an (aggregate) base level of capacity on routes of concern. Base levels of capacity have been set based on the capacity the parties operated prior to the alliances and provide for an obligation to grow capacity depending on airline performance. The maximum value of any growth obligation is capped in line with the greater of Australian GDP or total Australia-New Zealand passenger demand.

³⁵ Section 91(3)

³⁶ See *Re Medicines Australia Inc* [2007] ACompT 4 at [129].

³⁷ See *Re Medicines Australia Inc* [2007] ACompT 4 at [123].

³⁸ See for example A91332 & A91333, Qantas Airways Limited and Emirates, 27 March 2013 and A91362 & A91363, Virgin Australia Airlines Pty Ltd, Air New Zealand Limited and Others, 3 September 2013.

270. Obligations to grow capacity have been included to ensure that the applicants' capacity on relevant routes continues to grow in line with underlying passenger demand. However, the ACCC does not consider that a condition of this type would effectively address the anti-competitive detriment likely to be generated by the Proposed Conduct on the Sydney – Shanghai route.
271. The conditions applied in relation to trans-Tasman routes were applied to routes where growth has been slow and stable in recent years which is not the case on the Sydney – Shanghai route.
272. The Sydney – Shanghai route has grown by 17% over the last five years (seats flown on direct flights). More generally, the average annual growth rate in origin/destination traffic between Australia and China over the last five years has been 13.1%. The ACCC considers that setting a structural capacity condition, and in particular, determining the form a capacity growth obligation would take, on a route such as Sydney – Shanghai which is experiencing significant growth (and potential variability in growth), and where the Applicants control in excess of 80% of capacity (direct flights) on the route, would be problematic.
273. A capacity growth rate set too low (relative to demand on the route) risks not addressing the competition concerns identified, leaving open the possibility of the Applicants limiting capacity growth to raise fares. A capacity growth rate set too high risks the Applicants having excess capacity on the route thereby crowding out Air China and raising barriers to entry.
274. The ACCC also notes that the capacity conditions currently applied to the trans-Tasman alliances require an aggregate level of capacity to be maintained across all relevant routes. This provides the applicants with flexibility about how they allocate capacity to individual routes (i.e. there is no minimum capacity requirement in relation to individual routes). Any capacity condition designed to address the anti-competitive detriment likely to result from the Proposed Conduct would not have this flexibility. A route specific capacity condition would also give airports significant bargaining power in negotiations with the Applicants, knowing that the Applicants were obliged to maintain a stipulated level of capacity on the route.
275. Therefore, the ACCC considers that it would be very difficult, if not impossible, to design a capacity obligation that would address concerns that the public benefit likely to result from the Proposed Conduct will not outweigh the likely public detriment, including the detriment constituted by any lessening of competition that would be likely to result.
276. Accordingly, the ACCC does not propose to grant authorisation.

Draft determination

The applications

277. 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.
278. 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.
279. 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.
280. Subsection 90A(1) of the CCA requires that before determining an application for authorisation the ACCC shall prepare a draft determination.

The net public benefit test

281. For the reasons outlined in this draft determination, the ACCC is not 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.
282. For the reasons outlined in this draft determination the ACCC is not 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.
283. The ACCC therefore proposes to deny authorisation to applications A91470 and A91471.
284. This draft determination is made on 24 March 2015.

Next steps

285. The ACCC now seeks submissions in response to this draft determination. In addition, consistent with section 90A of the CCA, the applicant or an interested party may request that the ACCC hold a conference to discuss the draft determination.

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.