



## **PUBLIC REGISTER VERSION**

### **PUBLIC BENEFITS OF THE PROPOSED JOINT COORDINATION AGREEMENT, AUTHORISATION NUMBERS A91470 AND A91471**

On 19 May 2015, the Commission requested further information in relation to the public benefits associated with the proposed Joint Coordination Agreement (JCA) between Qantas and China Eastern.

The Applicants have previously provided the Commission with information about how the Proposed Conduct will give them the ability to offer a more competitive, improved and sustainable proposition for passengers travelling between Australia and China. Specifically, the Proposed Conduct will:

- strengthen Shanghai as a hub and increase passenger traffic flows in both directions;
- enable and expedite capacity increases on new and existing routes;
- deliver shorter journey times, improved connectivity and destination choice for passengers flying between Australia and China;
- improve schedule spread and associated connectivity;
- expand the destinations covered by the codeshare arrangements, while incentivising both carriers to sell more on each other's services through a greater range of price points;
- provide greater flexibility and certainty for Australian businesses who, pursuant to free trade arrangements, have increasing need to access trade and export opportunities in both Shanghai and secondary cities in China;
- significantly boost inbound Chinese tourism by expanding Qantas' brand awareness and distribution capability throughout China and by making it easier for more tourists from more areas of China to visit and spend time and money in more parts of Australia;
- result in improved products and services for customers travelling through Shanghai as a result of improved lounge facilities and coordinated customer service;
- provide enhanced benefits for members of both Applicants' frequent flyer programs, particularly through increased earning and redemption opportunities;
- help ensure the financial viability of Qantas' operations in China, preserving and extending the only Australian carrier's presence in China;
- expedite and sustain the growth of China Eastern in Australia, leading to further employment in Australia and other economic benefits; and
- provoke a pro-competitive response from rival carriers and hubs in the region.

Such benefits will not be achievable in the counterfactual position, in which the status quo would continue in the form of an arm's length codeshare arrangement with more limited scope and reach.

Without the Proposed Conduct:

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

Additional information about public benefits is set out below.

### **Improved hub and increased traffic flows**

By facilitating a successful 'gateway strategy' for both Qantas and China Eastern, the Proposed Conduct will increase the attractiveness of Shanghai as a hub for connecting services between mainland China and Australia. This will dramatically improve the ability of Shanghai to compete against other hubs such as Hong Kong, Singapore, Beijing and Guangzhou and lead to increased passenger growth than would otherwise be the case.

While no discrete analysis has been done to estimate the level of increased through traffic, Qantas' expectations of increased passenger growth are based on long industry experience and the implementation of gateway strategies in other regions.

For example, Qantas' strategy of accessing North America through dual gateways (Los Angeles and Dallas Fort/Worth) has enabled Qantas passengers to access multiple new destinations with better connections and shorter journey times. The alliance with American Airlines (AA) enabled Qantas to expand capacity and introduce new services to a second hub in the United States, Dallas/Fort Worth, in 2011. This has given Australians unprecedented access to destinations across the US. Dallas/Fort Worth is one of the US' major hub airports, the fourth-largest and fastest-growing metropolitan area in the US and an important centre of business and tourism. Dallas/Fort Worth is also the primary hub of AA. From here AA and its regional partner, American Eagle, operate to 200 destinations worldwide and across the US, Canada and Mexico (including Boston, Orlando, Houston, Las Vegas, Miami, Nashville, Calgary, Toronto and Vancouver). In response to demand for the Dallas/Fort Worth services, in July 2012, Qantas increased service frequencies and, in September 2014, up-gauged the Boeing 747 service to its flagship Airbus 380 product.

Similarly, coordination with Emirates has enabled Qantas to hub its European services through Dubai, again opening up new one-stop connectivity for Australians wishing to access Europe and the Middle East in a way which was otherwise only possible through a minimum two-stop proposition. In turn, this has prompted not only pro-competitive responses from rival carriers competing via alternative hubs (such as Cathay Pacific, Singapore Airlines and Etihad Airlines), but also other consumer benefits including increased inbound tourism to Australia and associated economic benefits. The increased passenger activity on Qantas marketed flights (on both Qantas and Emirates operated flights) to/from Australia to Europe is set out in Table 1 below.

### Table 1: Increased Passenger Activity to Europe

#### **[REDACTED – COMMERCIAL IN CONFIDENCE]**

Although there are differences between the Australia-Europe and Australia-China market dynamics, Qantas expects passenger volumes to and from China to increase as a result of the Proposed Conduct. Increased traffic will, in turn, provide the basis for further public benefits.

#### **Expedited capacity expansion**

The Proposed Conduct will facilitate and expedite the deployment of additional capacity to Australia. It will also make capacity increases more sustainable.

HoustonKemp's analysis of the proposed financial arrangements confirms that, rather than giving the Applicants any ability or incentive to restrict growth and increase prices, **[REDACTED – COMMERCIAL IN CONFIDENCE]**.

If the Proposed Conduct is authorised, the expanded capacity will be implemented in the form of:

- introducing new services **[REDACTED – COMMERCIAL IN CONFIDENCE]** not currently operated by the Applicants; and
- aircraft up-gauging and increases in frequencies on routes currently operated.

**[REDACTED – COMMERCIAL IN CONFIDENCE]** The Proposed Conduct provides the incentive for China Eastern to point more of that new capacity at Australia. It will enable China Eastern to build on Qantas' domestic business and frequent flyer proposition by accessing high-yielding Australian domestic corporate and government travellers. It will give China Eastern's worldwide sales force better access to sell to and from Australia, particularly by being able to offer more seamless travel to secondary and regional cities served by Qantas.

#### **[REDACTED – COMMERCIAL IN CONFIDENCE]**

In addition, if the Proposed Conduct is authorised there is potential for the Applicants to explore the introduction of new services between Perth and Shanghai, a route not currently operated. **[REDACTED – COMMERCIAL IN CONFIDENCE]**

Due to the additional traffic which will be stimulated, the Proposed Conduct also makes it more likely that both carriers can sustain and expand frequencies between Sydney and China.

Specifically, contingent upon the Proposed Conduct, China Eastern will introduce new capacity:

- on Sydney-Shanghai, operating an A330 aircraft three times a week from September 2015, moving to daily in November 2015;
- on Melbourne-Shanghai, operating an A330 aircraft three times a week from September 2015, moving to daily in November 2015; and
- on Cairns-Shanghai, operating an A330-200 aircraft on a seasonal basis from 15 January 2016.

In addition, if the Proposed Conduct proceeds, subject to fleet constraints and slot availability, **[REDACTED – COMMERCIAL IN CONFIDENCE]**. Over time, if the Proposed Conduct proceeds, Qantas would potentially explore opportunities to introduce new services to China, **[REDACTED – COMMERCIAL IN CONFIDENCE]**

In the absence of the Proposed Conduct, this capacity expansion will not occur. **[REDACTED – COMMERCIAL IN CONFIDENCE]**

## Improved schedule spread and associated connectivity

Currently, Qantas and China Eastern operate similarly timed services between Sydney and Shanghai.

**Table 2: Current Schedule Sydney-Shanghai-Sydney**  
**Based on Northern Summer 2015 Schedules**

Carrier	Depart Sydney / Arrive Shanghai	Depart Shanghai / Arrive Sydney
Qantas	0935 / 1835	1955 / 0830
China Eastern	1100 / 1920	2020 / 0900+1

The introduction of an additional China Eastern service from September 2015 will add further flexibility to the existing schedule. The Proposed Conduct will therefore mean that the Applicants' services are better spread to allow morning and evening departures from Sydney which will in turn significantly increase connectivity and provide an improved proposition to better compete with rivals.

**Table 3: Proposed Schedule Sydney-Shanghai-Sydney**  
**Based on Northern Winter 2015 Schedules**

Carrier	Depart Sydney / Arrive Shanghai	Depart Shanghai / Arrive Sydney
Qantas	1050 / 1830	2005 / 0940 + 1
China Eastern	1200 / 1920 2130 / 0500+1*	2020 / 1000+1 2355 / 1335+1*

*\*New services contingent on Proposed Conduct*

Similarly, the Proposed Conduct will provide an incentive to further differentiate the departure times of any further additional Sydney-Shanghai services from existing services, in order to stimulate demand and attract passengers seeking flexibility in departure times. This might include introducing a morning departure from Shanghai to provide an even greater spread of timing options across the day.

The financial arrangements under the JCA [REDACTED – COMMERCIAL IN CONFIDENCE], making it more likely that they can market and inventory manage services on non-peak timings to make them attractive and commercially viable. Improved schedule spread gives increased connectivity options, providing further flexibility for consumers.

However, under a more limited codeshare arrangement, the Applicants are highly unlikely to take the unilateral risk of offering a departure time outside traditional peak flying times, meaning that consumer choice will remain more limited.

## Expansion of codeshare destinations

If the Proposed Conduct is authorised, the Applicants will increase the range of destinations covered by their current codeshare arrangements. [REDACTED – COMMERCIAL IN CONFIDENCE]

The expansion of codeshare destinations and the wider access to inventory represent fundamental changes to the current limited proposition. This will allow both carriers to offer:

- significantly expanded choices in terms of destinations; and
- a broader range of price points than is currently possible.

Expansion of the codeshare arrangements, coupled with joint marketing, will increase customer choices and drive more bookings in both points of sale. In China, travel agents will become increasingly aware of expanded options that can be booked across the Qantas domestic and Trans-Tasman network. [REDACTED – COMMERCIAL IN CONFIDENCE] Travel agents in China are therefore a critical intermediary in reaching such a large customer base.

An expanded codeshare arrangement would mean that Chinese tourists could fly on China Eastern's code on Qantas operated flights beyond the major Australian gateways to more regional parts of Australia, thereby disseminating valuable tourist spend. As discussed below, this will have important spill over effects within the wider Australian economy, particularly by generating more employment within the tourism sector.

### [REDACTED – COMMERCIAL IN CONFIDENCE]

In the absence of the Proposed Conduct, the Applicants will not have any commercial incentive to expand the existing codeshare [REDACTED – COMMERCIAL IN CONFIDENCE]. Expanding the ability for the China Eastern code to be placed on Qantas services will assist in maximising sales for both carriers. In turn this will assist Qantas to ensure that its operations to China remain sustainable, preserving a long term presence in China.

### **Enhanced Frequent Flyer benefits**

Currently, Qantas Frequent Flyer members can earn and redeem points on China Eastern's network. Likewise, China Eastern's Frequent Flyer members can earn and redeem on Qantas' network. However, there is limited earn and redemption activity.

The Proposed Conduct provides the commercial incentive to improve the frequent flyer proposition and customer experience for each airline's loyal customers, particularly those with a particular membership tier status. Some of the potential benefits for eligible members that may be agreed and implemented over time include:

- priority check-in, enabling an efficient airport experience regardless of the class of travel;
- additional checked baggage allowance, providing customers additional flexibility to travel on either Qantas or China Eastern services;
- priority boarding, giving passengers the opportunity to board at their leisure on either Qantas or China Eastern services;
- lounge access, providing an improved pre-flight experience when travelling on Qantas or China Eastern, regardless of their class of travel; and
- on-board recognition, providing China Eastern members a similar service level on-board to that offered to Qantas Frequent Flyer members.

In addition, the Proposed Conduct will provide the commercial incentive to invest in systems development that would enable the booking of award flights online through [qantas.com](http://qantas.com), rather than the current booking method which is by calling the Frequent Flyer Service Centre (involving a manual search for flights by an agent, which is a time consuming task that incurs an Award Assistance Fee of 6,000 Qantas Points per passenger per booking). Online award flight booking functionality provides members with increased flexibility to book as well as increased visibility of award seat options over a wide range of dates (the system returns a view across a 30 day period rather than the single day view a reservation agent receives).

The Proposed Conduct is also likely to provide the incentive to engage in cross promotional activities using each Applicant's membership base (such as offering bonus points to stimulate demand) and other joint marketing initiatives.

The Applicants would have no incentive to improve the frequent flyer proposition in the absence of the Proposed Conduct.

### **Terminal co-location in Shanghai**

Co-location of Qantas and China Eastern in Terminal 1 at Shanghai Pudong Airport will deliver a number of public benefits, including improved connectivity and increased schedule choice.

Currently, passengers connecting between Qantas and China Eastern operations in Shanghai are required to collect checked-in baggage, clear customs and proceed to transfer shuttles to move between Terminal 1 and Terminal 2. To facilitate this connection, a lengthy Minimum Connecting Time (MCT) of 2 hours 30 minutes is required to support the transfer process to ensure passengers have sufficient time to present for the onward connections. This makes the Shanghai hub proposition significantly less attractive than that offered in Hong Kong (where there is a MCT of only 60 minutes, as a result of seamless and customs-free passenger and baggage transfer arrangements.)

Co-location with China Eastern in Terminal 1 in Shanghai will remove the requirement for passengers to transfer between terminals, enabling the MCT to be significantly reduced. As a result, Qantas passengers will have unprecedented access to a far bigger range of one-stop same-day connections using China Eastern's broad range of services from Shanghai.

With authorisation, the Applicants will work together to identify and improve connectivity on services beyond Shanghai. While scheduling varies between seasons, preliminary analysis indicates that there is great scope for accessing currently untapped passenger pools. For example:

- based on the Applicants' Northern Winter 2014 schedules, terminal co-location would enable access to 56 additional frequencies and 9 new destinations. Some key additional connection options include services from Shanghai to Chengdu, Dalian, Beijing and Xian; and
- based on the Applicants' Northern Summer 2015 schedules, terminal co-location would enable access to 40 additional frequencies and 2 new destinations (Sanya and Linyi).

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

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

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

Co-location is highly unlikely to occur absent the Proposed Conduct. **[REDACTED – COMMERCIAL IN CONFIDENCE]**

### **Increased inbound tourism**

Opening up new connectivity through the gateway strategy described above will attract greater numbers of passengers to Qantas and China Eastern services. This will drive significant increases in inbound tourism to Australia and, by strengthening the presence of Qantas as the only Australian carrier operating to China, will drive the objectives of Tourism Australia's *Tourism 2020 Strategy* to ensure tourism transport capacity and infrastructure is developed and sustainable. The China 2020 Strategy acknowledges that:

*'More planes, with more connections to more destinations in Australia, aligned to the Geographic strategy will be essential to bring the increase in economic value to Australia.'*<sup>1</sup>

Combining China Eastern's distribution platform and brand strength in China with Qantas' extensive knowledge of the Australian market will significantly improve the profile of Australia as a destination for Chinese tourists. As set out above, terminal co-location will bolster the attractiveness of Shanghai as a hub for Australian passengers connecting to services to other parts of China and for Chinese travellers (particularly Chinese tourists) seeking to travel to Australia. This will be a step change from the current, weak proposition, which lacks the streamlined connectivity offered by competing hubs such as Hong Kong, Guangzhou and Beijing. Schedule coordination, improved lounge facilities and shorter journey times will allow the Applicants to offer passengers greater flexibility, comfort and convenience.

In turn, this will make Australia more easily accessible and readily chosen as a destination. This is particularly the case for Chinese tourists travelling from secondary cities within mainland China, who will experience improved connections and shorter journey times. For example, based on Northern Winter 2014 schedules, a Chinese tourist who resides in Dalian will have 14 additional frequencies to choose from in travelling via Shanghai to Australia. Similarly, a Chinese tourist from Xian will have 7 additional frequencies to choose from in travelling via Shanghai to Australia, whilst those living in Harbin or Yanji (who currently have no connection options through Shanghai) will have the choice of 7 connection options respectively.

Inbound tourism will also be boosted by increased awareness of Qantas as a brand and of Australia as a destination. Travel agents in China are a crucial part of the distribution chain. However, there is a natural tendency for travel agents in China to prioritise booking a long haul journey with a well-known, locally based Chinese carrier rather than an alternative foreign airline. Being associated with China Eastern and participating in joint marketing in China will help boost Qantas' profile among travel agents and therefore increase the likelihood of a travel agent selling an itinerary that includes Qantas coded services. This improvement in brand recognition and awareness of Qantas will, in turn, elicit a pro-competitive response from rival carriers.

At the same time, China Eastern will be able to sell a greater range of itineraries that include regional destinations within Australia on the Qantas network. This will make it more likely that Chinese tourists will visit more parts of Australia, lengthening their trip duration and increasing their travel spend. This will deliver important economic benefits to regional Australia, particularly cities outside the traditional tourist gateways and enable both Qantas and China Eastern to better compete against rivals (particularly China Southern, Air China and Cathay Pacific) who operate services to and from regional Chinese destinations to Australia via compelling hub propositions.

### **Public benefits identified and supported by third parties**

The Applicants urge the Commission to fully consider and place weight on the submissions lodged by interested parties which are overwhelmingly supportive of the Proposed Conduct, particularly in relation to the tourism and trade benefits. The Department of Infrastructure and Regional Development which is best placed to comment on likely implications for both the Australia-China bilateral relationship and the broader Australian economy. The Department states that:

*'It is the view of the Department that, on balance, the proposed agreement is a positive for the Australian economy and is consistent with the Australian Government's aviation policy settings...'*

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<sup>1</sup> Tourism Australia China 2020 Strategic Plan, p 3.

*'...the agreement would benefit Australian consumers by improving co-ordination of schedules and frequencies, sharing frequent flyer benefits between the two airlines, and allowing Qantas to offer its customers better access to destinations within China by reducing connection times for onwards flights from Shanghai. It would also result in added benefits by boosting Australia's tourism industry through increasing the ability of both airlines to market and sell tickets to Australian destinations.'*<sup>2</sup>

Tourism Australia cites the importance of the Tourism 2020 Strategy and the need to attract increased numbers of Chinese visitors given the significant value of Chinese tourism to the Australian economy. Specifically, Tourism Australia states:

*'The China market is also Australia's third largest in terms of visitor dispersal – travelling beyond the gateway cities of Sydney, Melbourne, Brisbane and Perth. Given the proposed joint cooperative agreement between Qantas and China Eastern would leverage both airline's domestic networks, it will potentially increase Chinese visitor dispersal by improving connectivity to Australia's regional areas.'*<sup>3</sup>

The Australia-China Relations Institute pointed to the wider context in which the Proposed Conduct must be reasonably assessed. It noted that:

*'Services exports such as tourism and education-related travel provide a strong basis for future growth. In the past year Chinese tourists spent \$5.4b in Australia. That puts us on track to meet Tourism Australia's plans to grow the Chinese spend from \$3.2b in 2010 to between \$7.4 bn-\$9b by 2020...*

*'Cooperation between QANTAS [sic] and China Eastern Airlines means that Australian and Chinese consumers will benefit from better access to more destinations...*

*'It is ACRI's view that the best outcomes for the bilateral relationship will often flow from cooperation between Australian and Chinese interests. The proposed partnership between QANTAS and China Eastern Airlines is a good example of this in practice.'*<sup>4</sup>

The importance of assessing the Proposed Conduct in its broader economic context was also addressed by the Ambassador of the People's Republic of China to the Commonwealth of Australia, Mr Zhaoxu who considered the Proposed Conduct to be in the long term interests of China and Australia:

*'...aviation plays an important role in promoting bilateral relationship, particularly in facilitating people-people exchange. The air-market between Australia and China is growing at a rapid speed and the collaboration agreement between China Eastern and Qantas, which was signed in the presence of Chinese President Xi Jinping and Australian Prime Minister Tony Abbott, will inject new momentum into aviation cooperation by meeting the growing demand for international travels.'*<sup>5</sup>

## **Conclusion**

In circumstances where:

- real public benefits are likely to be produced by the Proposed Conduct;
- any competitive detriment is unlikely given that:

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<sup>2</sup> Department of Infrastructure and Regional Development submission to the Commission dated 8 April 2015.

<sup>3</sup> Tourism Australia submission to the Commission dated 4 May 2015.

<sup>4</sup> Australia-China Relations Institute submission to the Commission (undated).

<sup>5</sup> Submission to the Commission (undated).

- the Applicants' limited operational overlap on the Sydney-Shanghai route will generate benefits, being the common link between two otherwise complementary networks, rather than detriments;
- the terms of the JCA specifically:  
**[REDACTED – COMMERCIAL IN CONFIDENCE]**
- the nature of the aviation industry is such that:
  - Qantas could not constrain such a significant, government-backed global carrier like China Eastern (even it wanted to);
  - any attempt by the Applicants to unjustifiably increase prices will not be effective or sustainable because the Applicants will continue to be constrained by a number of rivals throughout the region;
- in any event, any perceived detriment can be addressed by a capacity condition; and
- the counterfactual involves the only Australian carrier operating to China becoming increasingly marginalised **[REDACTED – COMMERCIAL IN CONFIDENCE]** to the detriment of the Australian community generally,

the authorisation test is clearly satisfied.

3 June 2015

**ATTACHMENT A**

**[REDACTED – COMMERCIAL IN CONFIDENCE]**