



Australian  
Competition &  
Consumer  
Commission

# Determination

Application for revocation of A91265 – A91266 and  
the substitution of authorisation A91502 – A91503

lodged by

Qantas Airways Limited and American Airlines

in respect of

their restated joint business agreement and  
associated agreements

Date: 25 February 2016

Authorisation numbers: A91502 – A91503

Commissioners: Rickard  
Schaper  
Court  
Cifuentes  
Featherston

## Summary

**The ACCC has decided to re-authorise Qantas and American Airlines to continue to coordinate their operations on trans-Pacific routes pursuant to their alliance.**

**The ACCC has decided to re-authorise the conduct for a further five years until 18 March 2021.**

**The ACCC granted interim authorisation on 9 July 2015 to facilitate the introduction of new services by the alliance partners.**

On 10 June 2015 Qantas and American Airlines (the Applicants) lodged an application for re-authorisation of their trans-Pacific alliance (the Alliance). The Alliance involves the Applicants continuing to coordinate their operations on trans-Pacific routes pursuant to a Restated Joint Business Agreement and associated agreements (Proposed Conduct).

The Applicants also requested interim authorisation to facilitate the introduction of two new Alliance services from December 2015. American Airlines introduced a service between Sydney and Los Angeles and Qantas introduced a service operating between Sydney and San Francisco. Interim authorisation was granted by the ACCC on 9 July 2015.

Qantas and American Airlines entered into their Alliance on 6 May 2011. The ACCC granted authorisation for the Alliance for five years on 29 September 2011. At the time, the ACCC noted that Qantas and American Airlines did not directly compete on any routes and considered that they were unlikely to compete in the supply of direct trans-Pacific services in the future.

The Applicants submit that neither airline can effectively and efficiently serve the trans-Pacific alone. Qantas' success remains dependent on accessing the breadth, depth and efficiency of the American Airlines network and sales and distribution channels in the US, Canada and Mexico. American Airlines is similarly dependent on Qantas' Australian sales and distribution channels and domestic network.

American Airlines has an extensive service offering across the US, Canada and Mexico but had not operated trans-Pacific services since 1992. The ACCC considers that, in the future without the Proposed Conduct, American Airlines is unlikely to commence trans-Pacific services in competition with Qantas, the Virgin/Delta alliance and the Air New Zealand/United alliance. There is no other carrier with a large Australian presence that American Airlines could partner with to compete, in an alliance, with Qantas, the Virgin Delta alliance and the Air New Zealand/United alliance.

Qantas is currently the largest operator of direct trans-Pacific services and has an extensive domestic network in Australia. The ACCC considers that, in the future without the Proposed Conduct, Qantas would be unable to offer services to non-gateway destinations in the US. This would make its offering less attractive to customers that wish to travel to/from these destinations, resulting in lower passenger numbers on trans-Pacific services. In turn, this is likely to result in some rationalisation of Qantas' current trans-Pacific service offering and/or delay the introduction of new frequencies and services.

The ACCC considers that the Proposed Conduct is likely to result in:

- material public benefits in the form of enhanced products and services including new frequencies and destinations, increased and better online

connections, better scheduling, greater loyalty program benefits and improved lounge access

- material public benefits in the form of the promotion of competition on the trans-Pacific
- small public benefits in the form of cost savings and efficiencies
- potential public benefits in the form of stimulation of tourism and trade.

The ACCC considers that the Proposed Conduct is unlikely to result in any significant detriment in any relevant area of competition. The ACCC's conclusion that American Airlines would be unlikely to operate trans-Pacific services in its own right absent the Alliance is a significant factor underpinning this view.

The ACCC is satisfied that the Proposed Conduct is likely result in a net public benefit and proposes to grant authorisation.

The Applicants sought re-authorisation for a period of 10 years. However, in light of the ongoing evolution of services on the trans-Pacific and the dynamic nature of the aviation industry, the ACCC considers it appropriate to review developments on the trans-Pacific earlier than requested and has decided to grant authorisation for five years until 18 March 2021.

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## The application for re-authorisation

1. On 10 June 2015 Qantas Airways Limited (**Qantas**) and American Airlines Inc (**American Airlines**) and their related bodies corporate (together, the **Applicants**) lodged with the ACCC an application for the revocation of authorisations A91265 – A91266 and substitution with authorisations A91502 – A91503 (re-authorisation). The Applicants are seeking re-authorisation to continue to coordinate their operations on trans-Pacific routes pursuant to their alliance (the **Alliance**), for a period of 10 years.
2. The Applicants also requested interim authorisation to enable them to engage in the proposed conduct while the ACCC is considering the substantive application. Interim authorisation was granted on 9 July 2015.<sup>1</sup>
3. In particular, interim authorisation was sought to facilitate the introduction of a new joint service between Sydney and Los Angeles operated by American Airlines and a new joint service between Sydney and San Francisco operated by Qantas under an expansion of their existing authorised Alliance.

## The Proposed Conduct

4. The Applicants are seeking re-authorisation to continue to coordinate their operations between and within Australia/New Zealand and the US, Canada and Mexico pursuant to a Restated Joint Business Agreement (**Restated JBA**) and associated agreements (the **Proposed Conduct**).<sup>2</sup> The Applicants seek re-authorisation for a period of 10 years.
5. The Applicants submit that the precise scope of co-ordination under the Alliance will evolve over its term and may be altered from time to time.
6. The Restated JBA and associated agreements provide for coordination in respect of:
  - marketing and sales
  - freight
  - pricing
  - scheduling
  - distribution strategies including agency arrangements
  - yield and inventory management
  - frequent flyer programs
  - lounges

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<sup>1</sup> See ACCC decision 9 July 2015 available at: <http://registers.acc.gov.au/content/index.phtml/itemId/1187050/fromItemId/278039/display/acccDecision>

<sup>2</sup> Amendment No 5 to the Joint Business Agreement, an Alliance Agreement, an Alliance Settlement Agreement and a Codeshare Agreement

- joint procurement and product and service standards.
7. The ACCC notes that the Alliance provides for the alignment of incentives through revenue sharing arrangements that result in metal neutrality. That is, the Alliance enables Qantas and American Airlines to be indifferent as to whether a passenger travels on Qantas or American Airlines operated services.
  8. The ACCC previously granted authorisation for similar arrangements in September 2011 for a period of 5 years. However, reauthorisation has been sought for the Restated JBA and associated agreements, which have been redesigned to take account of recent developments, including the commencement of services by American Airlines between Los Angeles and Sydney from December 2015.

## **Rationale for the Alliance**

9. The Applicants submit that neither Qantas nor American Airlines can effectively and efficiently serve the trans-Pacific alone and that Qantas' success remains dependent on accessing the breadth, depth and efficiency of the American Airlines network and sales and distribution channels in the US, Canada and Mexico. The Applicants submit that American Airlines will similarly be dependent on Qantas' Australian sales and distribution channels and domestic network.<sup>3</sup>

## **The Applicants**

### **Qantas**

10. Qantas was incorporated in 1920 and is Australia's largest domestic and international airline. The Qantas Group operates more than 6,600 domestic and 870 international flights each week using two complementary airlines: Qantas – a full service airline offering domestic and international services; and Jetstar – a low cost carrier offering domestic and international services, predominantly focussed on servicing price sensitive consumers.
11. Qantas also operates airline related businesses including airport support services, catering, freight operations, loyalty programs and engineering.
12. Qantas has an alliance with Emirates that was authorised by the ACCC in March 2013 and is also a party to the oneworld marketing alliance along with American Airlines.<sup>4</sup>

### **American Airlines**

13. American Airlines Group (AAG, formerly known as AMR Corporation) is a holding company, whose primary business is the operation of two major network carriers through its principal, wholly-owned mainline operating subsidiaries, American Airlines and US Airways. Together with regional partners, operating as American Eagle and US Airways Express, Piedmont Airlines, Inc, and PSA Airlines, Inc., the airlines operate an average of nearly 6,700 flights per day to nearly 350 destinations in more than 50 countries.
14. American Airlines and US Airways maintain hubs in Charlotte, Chicago, Dallas/Fort Worth, Los Angeles, Miami, New York, Philadelphia, Phoenix and Washington D.C.

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<sup>3</sup> Qantas submission, 10 June 2015, p.4.

<sup>4</sup> Qantas submission, 10 June 2015, pp. 5-6.

15. American Airlines' cargo division provides a wide range of freight and mail services, with facilities and interline connections available across the globe.
16. In November 2011, AMR Corporation filed voluntary petitions for relief under Chapter 11 of the US Bankruptcy Code. In October 2013, the Bankruptcy Court entered an order approving and confirming the Debtor's plan of reorganisation. The plan of reorganisation resulted in the merger of American Airlines and US Airways in December 2013.
17. The Applicants submit that the merger brought together two significant domestic networks giving travellers access to more destinations with greater ease. The company's emergence from bankruptcy through the merger also allowed American Airlines to successfully make substantial new investments in fleet, equipment, facilities and other improvements.<sup>5</sup>

## Background

### Initial authorisation and implementation of the Alliance

18. Qantas and American Airlines entered into their alliance pursuant to a Joint Business Agreement dated 6 May 2011 (the **Original JBA**). The ACCC granted authorisation for the Alliance as defined by the Original JBA for five years on 29 September 2011. The ACCC noted that Qantas and American Airlines did not directly compete on any routes and considered that they were unlikely to directly compete in the future.
19. The Original JBA was also authorised by the New Zealand Minister of Transport on 26 September 2011 and was approved by the US Department of Transportation (**US DOT**) on 9 November 2011.<sup>6</sup>
20. On 11 November 2015 the New Zealand Minister of Transport announced his decision under section 88 of the Civil Aviation Act 1990 to authorise the Restated JBA.
21. The Applicants also have an application for approval of and antitrust immunity for the Restated JBA with the US DOT.

### Air passenger travel between Australia and the US

#### Regulatory environment

##### The international aviation industry

22. The international aviation industry is highly regulated. The 1944 Convention on International Civil Aviation established the principle that each country has exclusive sovereignty over its airspace. This principle continues to guide the regulatory framework today.
23. International air transport cannot occur unless it is specifically authorised pursuant to a government to government bilateral air services agreement (**ASA**). An ASA

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<sup>5</sup> Qantas submission, 10 June 2015, pp. 7-8.

<sup>6</sup> The ACCC notes that the US DOT granted approval of the Alliance, but did not make a grant of antitrust immunity.

may specify the terms and conditions of airline activity between two countries. An ASA may indicate the destinations that can be served in a particular country, the permitted frequencies per week and any rights to operate via or beyond to other countries. Typically, the rights granted under an ASA can only be exercised by designated carriers of the countries that are parties to them.

24. An Open Skies Agreement (**OSA**) is one form of ASA between two countries. In essence, it is an agreement which provides minimal (or no) restrictions on the ability of the airlines of two countries to operate services between them.

### **OSA between Australia and the US**

25. The introduction of an OSA between Australia and the US in February 2008 enabled the entry and operation of unrestricted capacity on routes between the two countries by carriers from Australia or the US. Immediately before this time, Qantas and United were the only carriers operating direct services between Australia and the US.
26. Under the OSA, the carriage of traffic over domestic sectors is reserved for the national carriers of each country. The agreement only allows the beyond carriage of genuine international traffic between international gateways, such as Qantas' own traffic between Los Angeles and New York. As a result, international airlines from other countries depend on commercial arrangements with domestic carriers in order to effectively serve beyond gateway markets.

## **Airline operations between Australia and the US**

### **Passenger travel**

27. In calendar year 2014, approximately 2.5 million passengers travelled on single code flights between Australia and the US.
28. In the year ended September 2014, passenger data provided by the Department of Immigration and Border Protection (**DIBP**) through the Bureau of Infrastructure, Transport, and Regional Economics (**BITRE**) showed that the main purposes of travel for Australian residents travelling between Australia and the US, in decreasing order and excluding the 'other' category, were for holiday (67 per cent), visiting friends and relatives (**VFR**) (12 per cent), and business (10 per cent).
29. The majority of travellers between Australia and the US connect to and from beyond and behind destinations via key gateways in each country. Industry data provided by Virgin and Delta suggested that approximately 25 per cent of US-origin passengers and 40 per cent of Australia-origin passengers travel on a direct point-to-point service.<sup>7</sup>
30. Qantas has indicated that, on average, more than half of its passengers travelling from Australia to Los Angeles and Dallas Fort Worth connect to flights to travel beyond those gateways. Approximately two thirds of passengers travelling from Sydney to Dallas Fort Worth on Qantas flights connect to beyond locations.

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<sup>7</sup> See ACCC Determination A91475 – A91478 in relation to Virgin Australia and Delta Air Lines alliance, 14 August 2015, p.5.  
<http://registers.accc.gov.au/content/index.phtml/itemId/1184018/fromItemId/401858/display/acccDecision>

## Services between Australia and the US

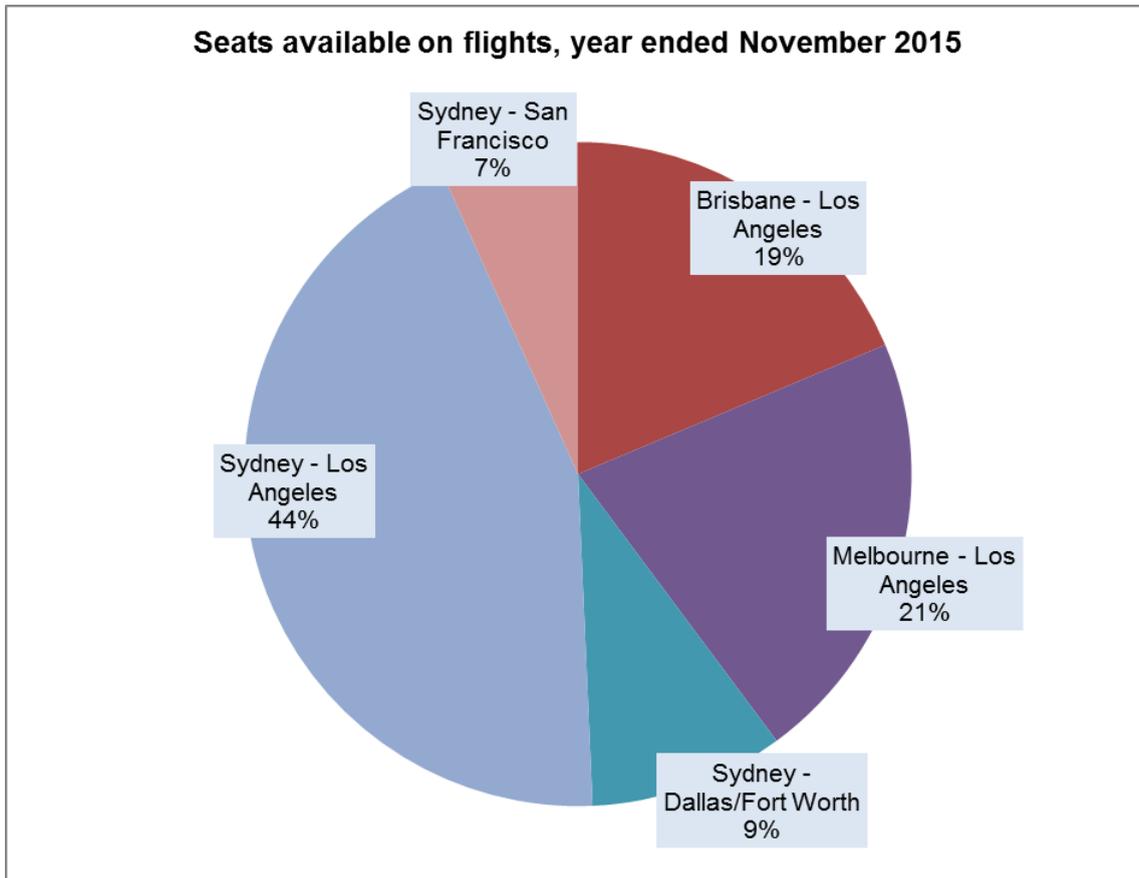
31. There were a total of 3.7 million available seats on flights between Australia and the US for the year ending November 2015. Of this, 2.9 million available seats were on direct flights between Australia and the mainland US.

32. There are currently eight direct services between Australia and the US:

- Sydney to Los Angeles, Dallas Fort Worth, Honolulu and San Francisco
- Melbourne to Los Angeles and Honolulu
- Brisbane to Los Angeles and Honolulu.

33. There are currently five direct services between Australia and the mainland US. The share of available seats on these services is shown below at Figure 1.

**Figure 1: Share of available seats, direct flights between Australia and the mainland US, year ended November 2015**



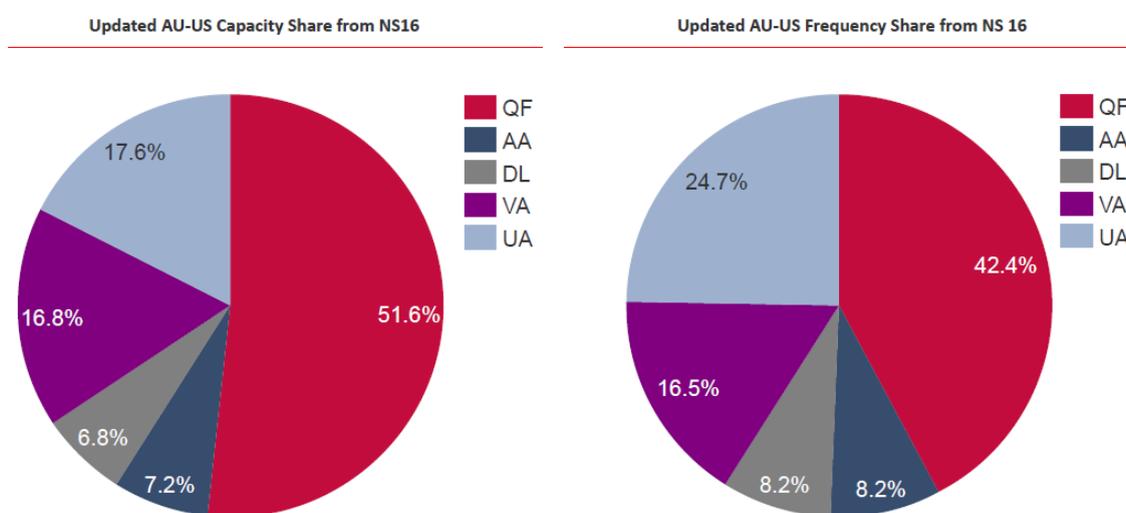
Source: BITRE

34. Qantas is the most significant carrier on the trans-Pacific with approximately 46 per cent of passengers between Australia and the US flying with Qantas in 2014.<sup>8</sup>

<sup>8</sup> This is based on ABS data. See Applicant submission, Annexure G.

35. Qantas accounted for 55 per cent of total capacity on the five direct routes between Australia and the mainland US in the year ended November 2015; and 48 per cent of capacity on the Sydney to Los Angeles route.
36. On 17 November, Qantas announced changes to its trans-Pacific services. Taking these changes into account, the Applicants submit that the combined effect of network adjustments as part of the Proposed Conduct will increase Alliance capacity between Australia and the mainland US by 11.4 per cent and total capacity between Australia and the mainland US by 6.4 per cent. Qantas provided estimated market shares on direct routes between Australia and the mainland US with these changes taken into account:

**Figure 2: Australia to mainland US capacity and frequency shares<sup>9</sup> with Proposed Conduct taken into account<sup>10</sup>**



37. As depicted above, the Alliance now has a 59 per cent share of capacity and a 51 per cent share of frequencies between Australia and mainland US.
38. Travel between Australia and the US is also available via indirect routes that involve at least one stop. The most commonly utilised one-stop service between Australia and the US is via Auckland, with other one-stop services including those via Hong Kong, Singapore, Abu Dhabi, Dubai, Fiji and Tahiti.

### Airlines operating between Australia and the US

39. There are currently four carriers that operate direct services between Australia and the mainland US: Qantas, Virgin, Delta, and United Airlines (**United**). From the Northern Summer 2015 Timetable Summary published by the Department of Infrastructure and Regional Development (**DIRD**):

- Qantas operated 37 return services per week:
  - Sydney to Los Angeles (14 return flights)
  - Brisbane to Los Angeles (7 return flights)

<sup>9</sup> Frequency share refers to the number of flights as a percentage of the total number of flights.

<sup>10</sup> NS = Northern Summer

- Melbourne to Los Angeles (10 return flights)
- Sydney to Dallas Fort Worth (6 return flights)
- United operated 21 return services per week:
  - Sydney to Los Angeles (7 return flights)
  - Melbourne to Los Angeles (7 return flights)
  - Sydney to San Francisco (7 return flights)
- Virgin and Delta operated a combined 21 return services per week:
  - Sydney to Los Angeles (14 return flights: 7 Virgin and 7 Delta)
  - Brisbane to Los Angeles (7 Virgin return flights).

40. In addition to these direct services to the mainland US:

- Qantas, Hawaiian Airlines and Jetstar operate services between Australia (Brisbane, Sydney, and Melbourne) and Honolulu; and
- Air Canada, Air New Zealand and Qantas operate indirect services between Australia and the mainland US via Canada and New Zealand.

41. As part of the expanded JBA, Qantas and American Airlines proposed a number of capacity and service changes on the trans-Pacific including:

- Commencement of new daily services between Sydney and Los Angeles from December 2015, operated by American Airlines with a B777-300 aircraft.
- Recommencement by Qantas of 6x/week services between Sydney and San Francisco from December 2015. In order to facilitate this Qantas redeployed four of its Sydney – Los Angeles services and one of its Melbourne – Los Angeles services to the new route.
- On 17 November 2015 Qantas announced its intention to further reduce its Sydney to Los Angeles services, but noted that customers would continue to have the option of twice daily flights as a result of American Airlines' services on the route.

## **Air freight services between Australia and the US**

42. Air freight between Australia and the US is carried by dedicated air freight aircraft and in the cargo holds of passenger aircraft. Freight is carried on both direct and indirect flights, with a large amount of freight being transported via intermediate points.

43. Qantas is the major carrier of air freight between Australia and the US. There are also a large number of other providers including other passenger carriers (e.g. Virgin, Delta and United) and third party dedicated freighters including FedEx and United Parcel Service.

## Consultation

44. The ACCC tests the claims made by an applicant in support of its application for authorisation through an open and transparent public consultation process.
45. The ACCC sought submissions from around 90 interested parties potentially affected by these applications. A summary of the public submissions received from interested parties and a response from the Applicants follows.

### Prior to interim authorisation

46. Submissions in support of interim authorisation and the application more broadly were received from several airports, industry associations and government bodies. In general, these submissions highlighted the significance of the US to Australian travellers as a destination and as a source of tourism in Australia.<sup>11</sup>
47. The ACCC also received submissions from Jumpjet Airlines and Air New Zealand that were opposed to interim authorisation.
48. The ACCC considered these submissions as part of its consideration of the Applicants' request for interim authorisation. As noted previously, the ACCC decided to grant interim authorisation on 9 July 2015. The ACCC's reasons for this decision are available on the public register: [interim authorisation decision](#)

### After interim authorisation

49. Hawaiian Airlines submits that:
  - immunised joint ventures reduce the competitive benefits that independent carriers provide because it is more difficult for them to reach arm's-length, procompetitive codeshare or other cooperative agreements with airlines in an immunised alliance
  - any reauthorisation of the Proposed Conduct should be conditional on Qantas entering into commercial relationships with competitive carriers like Hawaiian Airlines that enable sales to behind gateway destinations in Australia including assurances of inventory availability.
50. In relation to the condition suggested by Hawaiian Airlines, the Applicants submit that it is unnecessary, inappropriate and without any precedent in respect of authorisations in Australia. The Applicants further submit that independent carriers such as Hawaiian Airlines will not be 'locked out' as a result of the Proposed Conduct and that Qantas has a number of commercial relationships which give other carriers the ability to sell services within Australia.
51. The Applicants also submit that there are legitimate commercial reasons why Qantas has not previously entered into a commercial codeshare relationship with Hawaiian Airlines. However, the Applicants also note that Qantas has an interline agreement with Hawaiian Airlines, under which Hawaiian Airlines can sell any Qantas services in Australia or across the Tasman. Qantas submits that it offers similar interline access to Air Canada and United.

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<sup>11</sup> A list of the parties consulted and the public submissions received is available from the ACCC's public register [www.accc.gov.au/authorisationsregister](http://www.accc.gov.au/authorisationsregister).

52. The ACCC acknowledges Hawaiian Airlines' submission that independent carriers may find it more difficult to enter into arrangements with airlines in an immunised alliance. However, the ACCC notes that Qantas has an interline agreement with Hawaiian Airlines, under which Hawaiian Airlines can sell any Qantas services in Australia or across the Tasman. The ACCC also notes that Virgin continues to maintain a codeshare arrangement with Hawaiian and that its alliance with Delta does not preclude Virgin from extending that codeshare to destinations within Australia if it is commercially feasible to do so.<sup>12</sup> In the circumstances, the ACCC considers that a condition of the type proposed by Hawaiian Airlines is not appropriate.

## After draft determination

53. After issuing a draft determination as required by section 90(1) of the *Competition and Consumer Act 2010* (Cth) (the **CCA**), the ACCC invited submissions on the draft determination. The ACCC received a submission from Senator Nick Xenophon. Senator Xenophon submits that the Alliance will reduce competition and that fuel surcharges may be higher where airlines are part of an alliance.

54. Under the CCA, applicants and interested parties may also ask the ACCC to hold a conference to allow oral submissions on the draft determination. A conference was not requested.

55. The ACCC has taken the submission by Senator Xenophon into consideration along with the submissions made prior to the draft determination by the applicants and other interested parties as part of the ACCC's assessment of the applications for authorisation.

## ACCC assessment

56. The ACCC's assessment of the proposed conduct is carried out in accordance with the relevant net public benefit tests<sup>13</sup> contained in 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

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

- trans-Pacific air passenger transport services, including services between Australia or New Zealand and each of the US, Canada and Mexico
- Australian domestic air passenger transport services
- trans-Pacific air freight transport services

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<sup>12</sup> See ACCC Determination A91475 – A91478 in relation to Virgin Australia and Delta Air Lines alliance, 14 August 2015, pp.49-50.  
<http://registers.accc.gov.au/content/index.phtml/itemId/1184018/fromItemId/401858/display/acccDecision>

<sup>13</sup> Subsections 91C(4), 91C(7), 90(5A), 90(5B), 90(6), 90(7) and 90(8).

- the sale of international travel services
- the supply and acquisition of ancillary goods and services.

### **Trans-Pacific air passenger transport services**

58. The ACCC considers that the primary area of competition relevant to the assessment of the Proposed Conduct is trans-Pacific air passenger transport services, including:

- direct services between two international gateways on either side of the Pacific (e.g. Sydney or Melbourne to Los Angeles)
- one stop services originating from locations behind one of these gateways to a gateway on the other side of the Pacific (e.g. Adelaide-Sydney-Dallas or Las Vegas-Los Angeles-Sydney)
- two stop services that begin and end at locations behind and beyond gateways on either side of the Pacific (e.g. Adelaide-Sydney-Los Angeles-Las Vegas)

59. The ACCC notes that the relevant area of competition includes services between Australia or New Zealand and each of the US, Canada and Mexico. However, Qantas does not currently operate direct services to Mexico and its direct services to Canada are seasonal. Similarly, American Airlines does not offer any direct services between Australia and Mexico or Canada. Also, most trans-Pacific passengers fly between Australia and the US.<sup>14</sup> Accordingly, the ACCC has focussed on these services.

60. The ACCC has assessed the Proposed Conduct having regard both to its effects on international air passenger transport services as described at paragraph 58.

61. The ACCC acknowledges that passengers have a range of possible route choices in travelling between Australia and the US that include routes with additional stopovers (for example, via New Zealand or Canada). However, the ACCC considers that for many travellers these are not regarded as close substitutes for the most direct service.

62. The ACCC also 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) tend to be relatively more price sensitive and somewhat 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.

63. The ACCC considers that the differing characteristics of leisure and business passengers may suggest that each group could be assessed as separate parts of a

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<sup>14</sup> According to the Australian Bureau of Statistics, total passenger numbers in calendar year 2014 were 3,011,632 between Australia and the US, 532,383 between Australia and Canada and 53,653 between Australia and Mexico. These figures include indirect services.

broader market. However, in the context of considering the 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.

### **Australian domestic air passenger transport services**

64. The ACCC has previously recognised that an international aviation alliance could affect competition for the supply of domestic air passenger transport services by directing the onward carriage (i.e. inbound) traffic or feeder (i.e. outbound) traffic to a particular carrier (in this case, Qantas) at the expense of the competitive position of other domestic carriers.<sup>15</sup>
65. While customers flying with American Airlines on the trans-Pacific are likely to have an incentive to choose Qantas for any domestic Australian travel, Virgin receives feeder traffic from its alliance with Delta. In addition, it remains open to both Qantas and Virgin to compete for passengers flying between Sydney and Los Angeles with United.
66. The ACCC notes that it is possible for an alliance to lessen competition in the supply of domestic air passenger transport services through the bundling of domestic and international air passenger services. However, the Proposed Conduct does not change the number of airlines from which customers can acquire services. Further, it does not prevent or limit the ability of Virgin Australia to compete for such customers on its merits.
67. On this basis, the ACCC considers that bundling of services to customers under the Proposed Conduct is not likely to result in public detriment constituted by any lessening of competition in the supply of domestic air passenger transport services.
68. Accordingly, the ACCC considers that the Alliance is unlikely to result in any public detriments in the market for Australian domestic air passenger transport services and this market is not considered further in this determination.

### **Trans-Pacific air freight transport services**

69. The ACCC considers that the product and geographic scope of competition in the supply of these services is generally likely to be broader than the supply of international air passenger transport services (discussed above). In this regard, the ACCC notes:
- customers can arrange to move cargo internationally from location A to location B (say, from Sydney to LA) either in the hold of aircraft used for international passenger transport services or in dedicated freighter aircraft. Therefore, services offered by international passenger airlines and dedicated freighter airlines are also likely to be relevant; and
  - cargo transport customers are more likely than passenger transport customers to regard the direct and indirect service offerings of alternative service providers as close substitutes, since the 'inconvenience' of one or multi stop journeys is generally less of an issue for cargo than it is for passengers. Therefore, all routes between origin and destination, including

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<sup>15</sup> ACCC, Determination for applications A91332 and A91333 lodged by Qantas Airways Limited and Emirates (2013).

via intermediate points in other regions, are included in the geographic scope of competition.

70. The ACCC considers the existence of a number of other larger suppliers of air freight transport services on the trans-Pacific is likely to competitively constrain the Applicants.
71. Accordingly, the ACCC considers that the Alliance is unlikely to result in any public detriments in the market for trans-Pacific air freight transport services and this market is not considered further in terms of detriments in this determination.

### **The sale of international travel services**

72. In previous aviation alliance determinations, the ACCC has recognised a separate market for the sale of international travel services, which includes tickets sold directly by airlines and through indirect channels such as travel agents.
73. The ACCC considers that the Proposed Conduct is likely to have minimal, if any, impact on competition in the market for the sale of international travel services. The ACCC notes there are a range of competitors in this market including travel agencies (online and in shop fronts), direct distribution by airlines as well as the increasing presence of global internet portals such as Expedia and Webjet.
74. Given the negligible nature of any likely impact, the ACCC has not considered further the effect of the Proposed Conduct on the sale of international travel services in this determination.

### **The supply of ancillary goods and services**

75. The ACCC has considered the impact of the Proposed Conduct on the markets for the supply of ancillary services including ground handling, aircraft maintenance, catering and aircraft cleaning.
76. As set out in its consideration of the likely future without the Proposed Conduct, the ACCC considers that American Airlines is unlikely to operate trans-Pacific services. Further, American Airlines does not currently supply ancillary goods and services in Australia.
77. Taking into account the available information, including the presence of other third party providers, the ACCC considers that the Proposed Conduct is unlikely to have any impact on competition for the supply of ground handling, aircraft maintenance, catering and aircraft cleaning services. Accordingly, these markets are not considered further in this determination.

### **The procurement of ancillary goods and services**

78. The Proposed Conduct extends to the Applicants jointly procuring products and services such as fuel, ground handling services, aircraft maintenance, catering and aircraft cleaning.
79. 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 air passenger transport services (in particular, the procurement of aircraft, aviation fuel, catering products and ground handling services). In theory, there may be an anti-competitive impact if the Alliance creates market power in the acquisition of

any of these services. A second potential anti-competitive effect could occur if American Airlines switched its acquisition of services to Qantas, foreclosing third party suppliers.

80. The ACCC has had regard to:

- the absence of any procurement of Australian ancillary goods and services by American Airlines in the absence of the Proposed Conduct
- the relatively large number of alternative acquirers of these products
- the bargaining power of the large corporations that supply many of the inputs
- the fact that many of the inputs are acquired on an international basis.

81. The ACCC, taking into account the information, evidence and submissions before it, considers that the Applicants' joint procurement of various goods and services is unlikely to have any impact on competition in any relevant market. Accordingly, joint procurement is not considered further in this determination.

## **Future with and without**

82. To assist in its assessment of the proposed conduct against the authorisation tests, the ACCC compares the benefits and detriments likely to arise in the future with the conduct for which authorisation is sought against those in the future without the conduct the subject of the authorisation.

83. In considering the likely future without the Proposed Conduct the following questions are relevant:

- Is it likely that American Airlines would operate trans-Pacific services without the Alliance?
- What is the likely effect on Qantas' trans-Pacific services if the Alliance were not re-authorized?

## **Is it likely that American Airlines would operate trans Pacific services in the absence of the Alliance?**

84. Between February 1990 and March 1992 American Airlines offered a one-stop service between Dallas/Fort Worth and Sydney stopping in Honolulu.<sup>16</sup> American Airlines has not operated trans-Pacific services since that time.

85. The Applicants submit that American Airlines' commencement of services between Sydney and Los Angeles is only made possible by the existing cooperation between the applicants, new equipment and labour agreements following Chapter 11 Bankruptcy proceedings and American Airlines' merger with US Airways.<sup>17</sup>

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<sup>16</sup> <http://aviationblog.dallasnews.com/2015/06/american-airlines-to-start-los-angeles-sydney-australia-flights-in-december.html/> accessed 13 October 2015.

<sup>17</sup> Applicant submission, 10 June 2015, p.3.

86. The Applicants submit that neither airline can effectively and efficiently serve the trans-Pacific routes alone and that American Airlines' success on the trans-Pacific is dependent on accessing Qantas' network in Australia.
87. Under the alliance American Airlines introduced seven return services between Sydney and Los Angeles each week. There are currently 76 direct services between Australia and the mainland US being:
- 34 weekly return services operated by Qantas
  - 21 weekly return services operated by United
  - 21 weekly return services operated by Virgin/Delta.
88. The ACCC considers that the ability to combine with Qantas' substantial existing services and the alignment of incentives for Qantas and American Airlines under the Alliance is likely to significantly mitigate the risks that American Airlines would face as a standalone operator of trans-Pacific services.
89. The ACCC also notes that each of the other airlines offering direct trans-Pacific services benefits from their partnership with an airline based on the opposite side of the Pacific. That is, Virgin with Delta and United with Air New Zealand.
90. While it is possible that American Airlines could offer trans-Pacific services in its own right absent the alliance (to ensure efficient utilisation of assets that have become available through the merger with US Airways) on current information the ACCC does not consider this a likely scenario. As noted, American Airlines' trans-Pacific operations under the Alliance are relatively small scale, with services currently only on a single route.<sup>18</sup> It would likely require a much greater number of frequencies and services to compete with incumbents.
91. In the circumstances, the ACCC does not consider there is sufficient evidence to suggest that American Airlines would be likely to operate trans-Pacific service in the future without the Proposed Conduct.

### **What is the likely effect on Qantas' trans-Pacific services if the Alliance were not re-authorised?**

92. Qantas depends on an alliance partner to offer its customers full access to non-gateway destinations in the US.
93. The Applicants submit that the success of Qantas' trans-Pacific services remains dependent on accessing the breadth, depth and efficiency of the American Airlines network and sales and distribution channels in the US, Canada and Mexico. The Applicants submit that absent the Proposed Conduct, they would not have any ability to work together to grow the trans-Pacific Routes nor to provide each other with access to inventory on the respective domestic networks in order to maximise connectivity and customer choice.
94. The Applicants note that Qantas had not operated on the Sydney to San Francisco route since April 2011, despite San Francisco being one of the most popular onward destinations for Qantas' customers travelling to the US. The Applicants suggest that

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<sup>18</sup> The ACCC notes that on 11 November 2015 American Airlines also announced its intention to introduce a service between Auckland and Los Angeles from June 2016.

Qantas' re-commencement of Sydney to San Francisco services from December 2015 is only made possible by the freeing up of Qantas capacity on the Sydney to Los Angeles route, following the commencement of American Airlines services.

95. The ACCC accepts that the announced re-commencement of Qantas' Sydney to San Francisco service is largely facilitated by the addition of American Airlines metal to the Sydney to Los Angeles route and that this would not be the case in the absence of the Proposed Conduct.

## Conclusion

96. On the basis of a range of public and confidential information, the ACCC considers that in the likely future without the Proposed Conduct:

- each Applicant would review the operation of its services between Australia and the US with a view to optimising their individual commercial performance:
  - For Qantas, this could mean reducing its trans-Pacific routes and/or frequencies for example by not re-commencing its Sydney to San Francisco service.
  - For American Airlines, the ACCC considers it would be unlikely to operate trans-Pacific services.
- neither Qantas nor American Airlines would have a commercial incentive to offer competitive access to each other's network
- the Applicants would continue to implement on a more limited basis some of the terms of their existing interline, codeshare and marketing agreements
- neither Qantas nor American Airlines would be likely to enter into arrangements with any other airlines which provide extensive behind and beyond networks at either end of the trans-Pacific routes.

## Public benefit

97. The CCA does not define what constitutes a public benefit and the ACCC adopts a broad approach. This is consistent with the findings of the Australian Competition 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.*<sup>19</sup>

98. There is widespread recognition that the realisation of potential public benefits from airline alliances depends on:

- network complementarities or, in other words, how complementary are the product and service offerings of the airlines concerned. That is, the extent to which an alliance allows each airline to increase access to a greater

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<sup>19</sup> *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.

number of geographic, product or functional markets than they have access to in the future without the alliance. A higher proportion of common destinations and products usually indicates a lower degree of complementarity (and vice versa).

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

99. The ACCC considers that the Alliance between Qantas and American Airlines has the potential to deliver public benefits as the carriers' networks are highly complementary and the Alliance provides for metal neutrality, thereby aligning the interests of both partners. There is also the possibility of a procompetitive response from other airlines operating on the trans-Pacific.

### **Overview of public benefits anticipated by the ACCC in 2011**

100. The Original JBA was authorised by the ACCC on 29 September 2011. The ACCC considered that the Original JBA would be unlikely to result in any public detriment and would deliver a number of public benefits including:

- providing consumers with improved schedules and connectivity, a greater choice of connection and stop-over options and the possibility of new and improved routes
- allowing expanded reciprocal lounge access and improved check-in processes
- facilitating new fare products
- enhancing the frequent flyer proposition
- potentially stimulating tourism.

101. The Applicants submit that the Original JBA has delivered all of these benefits.

102. The Applicants also note that there have been a number of significant developments since the Original JBA was authorised. For example, in 2011 Qantas began offering services to Dallas/Fort Worth and subsequently increased and upgauged those services.

### **Overview of public benefits submitted by the Applicants**

103. The Applicants submit that the Proposed Conduct is likely to deliver significant public benefits. Specifically, the Applicants submit that the Proposed Conduct will:

- facilitate the addition of significant new capacity, including on routes currently operated by only one carrier
- expedite future increased frequencies on trans-Pacific Routes
- improve connectivity and increase schedule choice for passengers flying from Australia/New Zealand to destinations within the US, Canada and Mexico
- improve products and services for customers including lounge facilities and coordinated customer service
- enhance benefits for members of each Applicants' frequent flyer programs, particularly through reciprocal earning and redemption opportunities for frequent flyer members
- elicit a pro-competitive response from rivals on the trans-Pacific Routes
- offer a greater availability and variety of price points for consumers through coordinated inventory management
- promote tourism in Australia and enhanced international trade opportunities for Australian businesses.

104. The ACCC considers that the claimed public benefits fall within the following broad categories:

- enhanced products and services
- operational and other efficiencies
- enhanced ability to compete, triggering a competitive response from rivals
- stimulation of tourism and enhanced trade opportunities.

105. The Applicants' specific claims, the views of interested parties and the ACCC's assessment of the likely public benefits from the Proposed Conduct follows.

### **Enhanced products and services**

106. The ACCC considers that the Proposed Conduct has and is likely to result in material public benefits through enhanced products and services. The ACCC has considered the extent to which the Proposed Conduct results in enhanced products and services under the following categories:

- facilitation of new routes and additional frequencies and seats
- increased and better online connections
- schedule optimisation
- greater loyalty program benefits
- improved lounge access.

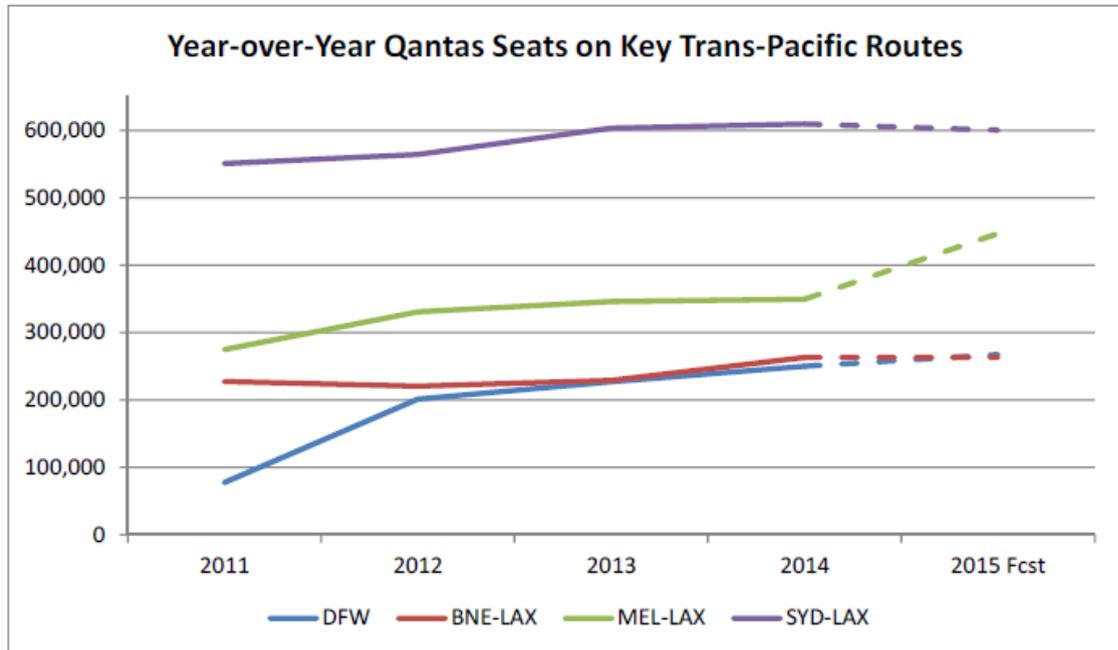
## ***Facilitation of new routes and additional frequencies and seats***

107. The Applicants submit that the Original JBA provided a platform to ensure the growth and viability of the Dallas/Fort Worth service. In July 2012, Qantas increased the frequency of the Sydney-Dallas/Fort Worth service to daily in response to increased demand. In September 2014, Qantas up-gauged the B747 service to its flagship A380 product. Although the frequency was reduced from daily to six per week, the change of gauge resulted in a 10 per cent increase in capacity on the route by adding nearly 50,000 additional seats and introduced first class as a new product proposition.
108. The Applicants submit that other examples of increased frequencies, aircraft up-gauging and capacity expansion that have been facilitated by the Original JBA include:
- from December 2013, Qantas increased the frequency of its six per week Brisbane-Los Angeles service to daily, resulting in a 15 per cent increase in capacity on the route
  - in September 2014, Qantas announced that it would introduce seasonal services between Sydney and Vancouver<sup>20</sup>
  - from December 2014, Qantas increased services to Honolulu from three to four per week on a year-round basis following an up-gauge from a B767 aircraft to a larger A330 aircraft. The Applicants submit that Honolulu is proving to be an increasingly popular stopover on journeys between Australia and the US
  - from January 2015, Qantas increased services on the Melbourne-Los Angeles route from daily to 10 per week, enabled through increased utilisation of its B747 fleet. A new evening service complements the Melbourne-Los Angeles daily A380 morning departure, offering customers greater choice and a different suite of connections to American Airlines' network upon arrival in Los Angeles.
109. The Applicants provided the following figure that depicts the trend in Qantas' capacity on key trans-Pacific routes since 2011:

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<sup>20</sup> Qantas operated six direct return services per week between Sydney and Vancouver during December 2014/January 2015. In February 2015, Qantas announced that it would operate a further extended seasonal schedule to Vancouver in June/July 2015 and in December 2015/January 2016, with 33 return services between Sydney and Vancouver (13 return services in June/July, and 20 return services from mid-December to late January 2016, operated by a three-cabin, 364-seat refurbished B747 aircraft).

**Figure 3: Qantas' capacity on direct trans-Pacific routes**



Source: BITRE (2011-2014); WorldNet (2015 Forecast)

110. As previously noted, the Applicants recently commenced services operated by American Airlines between Sydney and Los Angeles. They submit that this is only made possible in the context of the Alliance. As part of the new operation by American Airlines between Sydney and Los Angeles, Qantas has re-deployed aircraft from its Los Angeles services and re-commenced operations between Sydney and San Francisco with six services per week. Qantas had not operated on the Sydney-San Francisco route since April 2011 and the route was served only by United Airlines prior to Qantas' re-commencement of services.
111. The Applicants submit that the new services provided by American Airlines in conjunction with re-allocation of capacity will result in an 11.4 per cent increase in total Australia to mainland US capacity offered by the Alliance partners.
112. The ACCC considers that the Alliance has resulted in the addition of significant new routes and capacity during the previous period of authorisation.
113. The ACCC also considers that that re-authorisation of the Proposed Conduct provides a greater likelihood of new frequencies and destinations in future as the airlines benefit from passenger feeds arising from their complementary networks.
114. For the reasons set out above, the ACCC considers that the Proposed Conduct is likely to result in material public benefits by facilitating new routes and additional frequencies and Alliance seats.

### ***Increased and better online connections***

115. The ACCC has previously recognised that customers value online connections (passenger itineraries of two or more flight segments where connections are made between flights of the same airline, or its code share partners) more than interline connection options (connection between two different airlines). In particular, online connections may provide benefits including increased

convenience in not having to collect and bear baggage mid journey<sup>21</sup>; time savings associated with through check; and removal of the risk of forfeiting non-refundable fares if the first flight in their journey is delayed.

116. The ACCC has also accepted that airline alliances can confer public benefits to alliance customers by allowing them to access the other airline's schedule and, hence, additional frequencies and destinations.
117. The Applicants submit that neither Qantas nor American Airlines can effectively and efficiently serve the trans-Pacific routes alone. They further submit that more than half of Qantas' trans-Pacific customers travel to destinations beyond Los Angeles or Dallas Fort Worth.
118. The Applicants submit that the Original JBA has improved connectivity behind and beyond the trans-Pacific gateways. American Airlines codes on 26 Qantas routes, including all Qantas' trans-Pacific Routes. Qantas codes on 120 American Airlines routes (including 107 US routes, 8 Canadian routes and 5 in Latin America/Caribbean) and has access to 76 more through interline connections.<sup>22</sup>
119. The ACCC expects that the level of integration between the Alliance partners is likely to continue to grow if a further period of authorisation is granted.
120. The ACCC has previously recognised that customers value online connections much more than interline connection options, noting that this is also acknowledged in the economic literature in this area.<sup>23</sup>
121. To the extent that an airline alliance replaces interline connection options with online connection options for consumers, this may benefit consumers. These benefits may take several forms, including:
  - removal of the risk of forfeiting non-refundable fares if the first flight in a journey is delayed
  - increased convenience in not having to collect and bear baggage mid journey (where applicable)
  - time savings associated with through check (i.e. passengers do not need to allow time for a second check-in, where applicable) and better transit times.
122. The ACCC considers that the Alliance has resulted in significantly increased online connections for passengers on the trans-Pacific, particularly the customers who are using the services of the Alliance to connect to US domestic destinations. On the basis that more than half of Qantas' trans-Pacific passengers travel to locations beyond the US gateways and because the Alliance has and is likely to continue to facilitate a large number of online connections to other destinations,

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<sup>21</sup> The ACCC notes that baggage can often be through checked under interline arrangements also.

<sup>22</sup> Applicant submission, 10 June 2015, p.8.

<sup>23</sup> See, for example, Carlton, D., W. Landes, and R. Posner, 1980, 'Benefits and costs of airline mergers: a case study', *Bell Journal of Economics*, Vol. 11, pp. 65-83; Graham, D. R., D. P. Kaplan and D. S. Sibley 1983, 'Efficiency and competition in the airline industry', *Bell Journal of Economics*, Vol. 14, pp. 118-138; and Brueckner J. K 2003, 'International airfares in the age of Alliances: the effects of codesharing and antitrust immunity', *The Review of Economics and Statistics*, Vol. 85, No. 1, pp. 105-118.

the ACCC considers that the Alliance is likely to continue to result in material public benefits in the form of an increased number of online connections.

### ***Better schedule optimisation***

123. Airline alliances also enable transit times to be reduced through schedule optimisation. The ACCC notes that this benefit is more likely to be achieved in circumstances where the incentives of the airlines are aligned through revenue sharing arrangements such as those included in the Proposed Conduct.
124. The Applicants submit that prior to the introduction of the Dallas gateway, accessing many of their codeshare destinations via Los Angeles involved two or more stops for Australian passengers. With the introduction of the Qantas service to Dallas, passengers have better connectivity and streamlined journeys with reduced travelling time.
125. The Applicants submit that long connection times to reach high-demand destinations such as Chicago, Houston and Orlando have been reduced by the better coordination of schedules to and from Dallas. For example, transit times from Sydney to Houston and Austin have improved by almost three hours. Similarly, there has been a one hour improvement on connections to Chicago.
126. The ACCC considers that the joint schedule optimisation that has been facilitated by the Alliance is of benefit to travellers. The ACCC considers that the Proposed Conduct is likely to result in further public benefits arising from schedule optimisation into the future as new routes and frequencies are introduced, resulting in reduced travel and transit times.

### ***Greater loyalty program benefits***

127. The Applicants submit that over the course of the Original JBA, they have implemented comprehensive, reciprocal privileges for each other's frequent flyers when traveling on the other airline. The carriers now offer what are effectively fully reciprocal, earn-and-burn programs on all domestic and international flights.
128. The ACCC understands that the attractiveness of loyalty programs is defined by the ability to earn and redeem points on a wide range of network options (frequencies and destinations). The ACCC also understands that where permitted, passengers value the ability to travel for leisure using points earned while travelling for business with their employer's preferred airline.
129. The ACCC is of the view that the attractiveness of the Applicants' loyalty programs is enhanced under the Alliance and that the benefits of reciprocal access to loyalty programs are likely to accrue to Alliance passengers who:
  - under the Alliance, prefer to fly with Qantas or American Airlines, rather than United, Virgin/Delta or other airlines flying the trans-Pacific
  - are members of an Alliance loyalty program
  - value the ability to earn or use frequent flyer points.
130. The ACCC considers that the Proposed Conduct is likely to result in public benefits as a result of greater loyalty program benefits.

## ***Improved lounge access***

131. In its consideration of other aviation alliances the ACCC has previously accepted that:

- lounge access is important to business passengers and to the alliance's plans to better target corporate accounts and business travellers
- air-side lounges<sup>24</sup> are of greater value to business customers than land-side lounges.

132. The Applicants submit that they will continue to share enhanced lounge facilities, providing customers with a consistent, high standard of product, and that this will enable more effective management of customers who transfer between Qantas and American Airlines operations.

133. The ACCC considers that the Alliance is likely to provide American Airlines with stronger incentives to serve Qantas customers on an equal basis under the Alliance than under an access arrangement.

134. The ACCC considers that the Alliance has resulted in public benefits to consumers in the form of improved lounge access and that these benefits are likely to continue under the Proposed Conduct.

## **ACCC conclusion on enhanced products and services**

135. The ACCC considers that, collectively, the enhanced products and services delivered by the Proposed Conduct have resulted in a material public benefit.

136. The ACCC considers that it is likely that the Proposed Conduct will result in public benefits in the form of:

- facilitation of new routes and additional frequencies and seats
- increased and better online connections
- better schedule optimisation
- loyalty program benefits and improved lounge access

## **Operational and other efficiencies**

### ***Operational efficiencies***

137. 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.

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<sup>24</sup> Air-side refers to the area beyond security which is accessible only to airport staff and passengers holding valid boarding cards for imminent travel. Conversely, the land-side area is accessible to the general public.

138. The Applicants submit that efficiencies have been achieved, for example by utilising the respective home market sales and distribution networks of each carrier.
139. The Applicants also submit that their collaboration on airport operations and management has resulted in various product and service improvements, including in respect of bus access to terminals and the construction of new gate areas in Los Angeles.
140. The ACCC considers that the Applicants have provided limited substantiation of cost savings and efficiencies. Nonetheless, in principle, the ACCC considers that the Alliance is likely to facilitate small public benefits through cost savings and other efficiencies realised through the further integration of the Alliance partners over time.

### ***Removal of double marginalisation***

141. Double marginalisation occurs when suppliers of vertically related or complementary products each enjoy a degree of market power and independently charge a price which includes a mark-up over their marginal costs and do not take account of the impact on the other firm's profit.<sup>25</sup> The net result is both higher prices and lower profits than if the two firms coordinated their pricing, for example through vertical integration or a joint venture.
142. The ACCC considers that the extent of public benefit arising as a result of the removal or reduction of double marginalisation is likely to depend on:
  - the degree of market power held by Qantas in the Australian domestic market and the trans-Pacific market and American Airlines in the trans-Pacific and domestic US markets. This would be reflected in the magnitude of the mark-up above cost that these airlines realise on specific routes prior to the Alliance
  - the number of additional trans-Pacific passengers that are expected under the Alliance to purchase onward (complementary) flights beyond and/or behind direct services between Australia and the US.
143. The ACCC considers that any removal of double-marginalisation under the Alliance would be a benefit to trans-Pacific passengers who utilise a connection in Australia or a connection in the US that involves flights operated by both Qantas and American Airlines.
144. The extent of benefit available to these passengers is likely to vary across routes.
145. The ACCC considers that the removal of double marginalisation under the Alliance, to the extent that it occurs, is a benefit to the Applicants' passengers, and should lead to lower prices for journeys connecting separate services operated by each of the Applicants. The ACCC considers that the magnitude of this benefit is not readily quantified ex-ante. However, the removal of double marginalisation is likely to result in some public benefit.

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<sup>25</sup> The ACCC notes that in practice all firms have some degree of market power and charge a price which is above marginal cost. That is, all firms face a downward sloping demand curve.

### ***Pass through of cost savings and efficiencies***

146. The ACCC considers that cost saving and efficiencies are a public benefit in and of themselves. However, the ACCC gives greater weight to cost savings where they are likely to be passed through to consumers in the form of lower fares or better services.
147. The ACCC considers that the likelihood of cost savings and efficiencies achieved by the Alliance being passed through to consumers will depend on competitive conditions year to year, but accepts there is likely to be some pass through of realised cost savings and efficiencies in the form of lower fares or better services.

### **Enhanced ability to compete, triggering a competitive response from rivals**

148. The Applicants submit that the Proposed Conduct will elicit a competitive reaction from rival carriers, including more competitive fares and product/service offerings.
149. The Applicants submit that they expect a strong and swift reaction to the Proposed Conduct from competitors, particularly Virgin, Delta, United and Air New Zealand, who will fight to retain and gain passenger share that might otherwise be gained by the Applicants' enhanced ability to offer improved services across a wider network and with a new choice of product offered by American Airlines.
150. The Applicants submit that American Airlines operated flights on the trans-Pacific routes will create a new competitive dynamic by incentivising American Airlines to sharpen its strategic focus on Australia in order to make the new joint services a success. This, in turn, will stimulate responses from its US-based counterparts who will view this as a challenge to their international network offerings.
151. The Applicants submit that Australian consumers will be the direct beneficiaries of this intensified competition and that it will result in more efficient, better quality services and competitive pricing. The Applicants note that this would particularly affect those wishing to travel between Sydney and San Francisco as the re-commencement of Qantas operated services on this route is expected to immediately incite a pro-competitive response from the sole incumbent operator United.
152. The ACCC considers that the increase in trans-Pacific capacity as a result of the Restated JBA and in particular, the resumption of services between Sydney and San Francisco is likely to trigger competitive responses from the Alliance's rivals.
153. Since the Applicants applied for re-authorisation on 10 June 2015, there have been a range of announcements by rivals that arguably could be viewed as a competitive response to the Proposed Conduct. Such announcements include:
- 8 July 15 - Air Canada announced year-round Vancouver-Brisbane services commencing in June 2016<sup>26</sup>
  - 31 August 15 - United Airlines announced it will operate B787-9 Dreamliner aircraft on all Australian routes from March 2016<sup>27</sup>

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<sup>26</sup> <http://aircanada.mediaroom.com/index.php?s=43&item=901>

- 25 September 15 - Air NZ opened a new international lounge in Auckland with the CEO stating that the intent was to attract Australians flying via NZ to the US<sup>28</sup>
  - 8 October 15 - United announced Auckland-San Francisco B787 services commencing 3 July 2016 in coordination with Air NZ.<sup>29</sup>
  - 16 October 15 - United announced increased Economy class baggage allowance to two free checked pieces on flights between Australia and the US, for bookings from 04 Nov for travel on/after 17 December 2015<sup>30</sup>
154. The ACCC notes that the Alliance's product and service offering is greater than either airline could have offered alone. The Alliance is able to leverage this integrated network, through joint sales and marketing initiatives, to attract passengers who otherwise might not have flown with either Qantas or American Airlines.
155. The ACCC considers that the enhanced product and service offering under the Alliance - including new routes and additional frequencies and capacity, better scheduling, improved lounge access and greater loyalty program benefits - is likely to trigger a competitive response from rival providers of trans-Pacific services including Virgin/Delta and United/Air New Zealand. This is likely to result in material public benefit.

## Stimulation of tourism and trade

### *Tourism*

156. According to Tourism Australia, in 2013, the US was Australia's fourth largest inbound market for visitor arrivals and third largest market for total expenditure with a total spend of \$2.6 billion.
157. The Applicants submit that the Alliance will incentivise further publicity and marketing activity that may include campaigns designed to stimulate inbound tourism such as through sponsoring celebrity visits to Australia. In turn, this will enhance growth in US visitor numbers.
158. The Applicants submit that the Proposed Conduct is expected to increase inbound tourism to Australia through continued joint advertising campaigns that leverage Qantas' overseas profile and American Airlines' significant sales and marketing presence in the US, Canada and Mexico. The Applicants submit that inbound tourism will have spill over effects within the Australian economy, particularly by generating more employment within the tourism sector.
159. The Applicants submit that the introduction of American Airlines operated services will provide an opportunity to implement a comprehensive, collective strategy to

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<sup>27</sup> <http://www.traveller.com.au/united-airlines-will-switch-sydney-us-flights-to-787-dreamliners-gbjz6>

<sup>28</sup> *Travel Daily* 25 September 2015

<sup>29</sup> <http://newsroom.united.com/2015-10-08-United-Airlines-Made-SFO-the-Best-Pacific-Hub-And-Then-Found-3-Ways-to-Make-it-Better>

<sup>30</sup> <http://www.traveldaily.com.au/news/more-bags-on-united/239389>

promote the trans-Pacific services and a better chance of successfully stimulating tourism to Australia. They note that American Airlines will have increased commercial incentives to actively promote Australia as a holiday destination to residents of the US.

160. As the ACCC has noted in previous assessments of airline alliances, there are a wide range of factors that 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. Notwithstanding this, the ACCC has recognised the potential for airline alliances to increase tourism demand and expenditure.
161. The ACCC considers that stimulation of tourism is a potential source of public benefit under the Alliance. The ACCC considers that the principal ways in which the Alliance is likely to stimulate tourism are through:
- increased passenger traffic as a result of enhanced products and services and, potentially, lower fares to the extent that, on balance, the Alliance promotes rather than lessens competition and the Applicants pass through cost savings and efficiency gains to customers; and
  - exploitation of synergies through joint rather than separate tourism promotion activity. This occurs as the parties are able to internalise some of the externalities associated with tourism promotion expenditure.
162. The ACCC accepts that the Alliance has the potential to stimulate tourism spend in Australia (and the US). The Alliance provides a strong incentive for the Applicants to pursue joint marketing opportunities.
163. The ACCC considers that the extent of tourism benefits realised under the Alliance will be highly (positively) correlated with the additional trans-Pacific traffic that may be stimulated under the Alliance. The ACCC accepts that, on balance, the Alliance has the potential to have an overall stimulatory effect on trans-Pacific traffic. On this basis, the ACCC considers that the Alliance has the potential to generate tourism-related public benefits.

## **Trade**

164. The Applicants submit that the Proposed Conduct will enable Australian exporters to more readily access the Applicants' combined network and strengthen the bilateral relationship between Australia and the US. These ties will be strengthened as a result of American Airlines commencing operations to Australia.
165. The Applicants also submit that their respective freight teams have identified areas for further collaboration, including joint sales and marketing and the more effective carriage of freight to markets beyond the major gateways in both the US and Australia.
166. The Applicants submit that Australian businesses will directly benefit from the Proposed Conduct due to improved and increased services between Australia and the US. By continuing to grant Australian exporters improved access to American Airlines' expansive network, and by facilitating the re-commencement of direct Sydney-San Francisco services, the Proposed Conduct will deliver a

significant increase in international trade opportunities and increased supply chain certainty.

167. The Applicants also submit that as a result of the Proposed Conduct, American Airlines will actively promote secondary cities within Australia, particularly in domestic US, Canada and Mexico, where Qantas has limited reach today.
168. 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.
169. 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 the US.
170. The ACCC also considers that the key drivers of the volume and value of (non-tourism) trade between Australia and the US 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.
171. Notwithstanding this, the ACCC considers that the proposed conduct has the potential to result in some trade related public benefits by:
  - making it easier for foreign businesses to access non- gateway locations in Australia and, consequently, Australian goods and services that are unique to these places; and
  - making it easier for Australian exporters/importers to access locations in the US that are not directly served by Qantas and, thereby improving access to customers/suppliers in those locations.

### **ACCC conclusion on public benefits**

172. The ACCC considers that the Proposed Conduct is likely to result in:
  - material public benefits in the form of enhanced products and services including new frequencies and destinations, increased and better online connections, better scheduling, greater loyalty program benefits and improved lounge access
  - material public benefits in the form of the promotion of competition on the trans-Pacific
  - small public benefits in the form of cost savings and efficiencies
  - potential public benefits in the form of stimulation of tourism and trade.
173. Taken together, the ACCC is satisfied that the Proposed Conduct would, or would be likely to, result in material public benefits.

## Public detriment

174. 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 Australian Competition 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 principal elements the achievement of the goal of economic efficiency.<sup>31</sup>*

175. In its 2011 determination, the ACCC concluded that the Alliance was unlikely to result in any public detriment because the Applicants:

- did not directly compete on any routes
- were considered unlikely to directly compete in the future.

176. While the Proposed Conduct will result in American Airlines introducing trans-Pacific services between Los Angeles and Sydney, the ACCC notes that this is in the context of the Alliance and is not considered likely absent the Proposed Conduct.

177. The Applicants submit that the Proposed Conduct will not result in any public detriment in any relevant market and that it is inherently pro-competitive because:

- it will allow two complementary networks and business models to continue to deliver the significant public benefits
- it will increase competition and facilitate new public benefits
- it will not give the Applicants any ability or incentive to restrict capacity growth or increase airfares because the Applicants will continue to be disciplined by rivals including Virgin, Delta, United Airlines, Air New Zealand and Hawaiian Airlines.

## Trans-Pacific air passenger transport services

178. When conducting its assessment of any likely public detriments under the Alliance, the ACCC has focussed on whether the Alliance is likely to:

- give the Alliance an increased ability and incentive to unilaterally raise fares or reduce or limit growth in capacity on trans-Pacific air passenger services; and/or
- increase the risk of coordinated conduct among competing airlines providing trans-Pacific air passenger services.

## Unilateral effects

179. One of the main ways in which an airline alliance can lessen competition is through unilateral effects. An alliance can have unilateral effects if it removes or weakens competitive constraints in such a way that the alliance partners find it profitable to raise prices, restrict output or otherwise exercise any market power

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<sup>31</sup> *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

they may acquire as a result of the alliance, despite any expected response from other competitors.

180. In this instance, the ACCC considers that absent the Alliance, American Airlines would not be likely to operate trans-Pacific services. American Airlines would not compete in the Australian domestic air passenger services market and Qantas would not compete with American Airlines in the domestic air passenger transport services markets of the US/Canada/Mexico.
181. Accordingly, the ACCC considers that the Proposed Conduct does not materially enhance the ability and incentive of the alliance to unilaterally raise price.

### **Coordinated effects**

182. Another potential source of competitive harm from the Alliance is that it may increase the risk of coordinated conduct among airlines on trans-Pacific routes. Coordinated conduct in this sense involves competing airlines recognising and accommodating their mutual interdependence (explicitly or tacitly) by not competing as aggressively as they otherwise would.
183. The Applicants submit that the Proposed Conduct does not make anti-competitive coordinated effects between the various alliances operating on the trans-Pacific Routes any more likely to occur. They submit the Proposed Conduct will achieve the opposite, by introducing a fifth operator of direct services between Australia and the US and by eliciting intensified competition among the rivals as a result of the increased capacity and introduction of new product choice.
184. The ACCC considers that the routes between Australia and the mainland US have the following characteristics that may be more conducive to coordinated conduct:
- a small number of airlines operating on the routes
  - the small size and high frequency of customer transactions
  - transparency of each airlines' price and short term capacity decisions, which allows airlines to more easily signal increased prices and deviations from the coordinated level
  - low likelihood of new entry on the routes in response to any increase in price.
185. However, the ACCC considers that these routes also have the following characteristics that may disrupt or undermine coordinated conduct:
- ongoing product innovation and demand growth on these routes
  - Virgin, Delta, Qantas, United and American Airlines, have different incentives in other markets. In particular, Virgin and Qantas compete in the domestic Australian market while Delta, United, and American Airlines compete in the domestic US market
  - the existence of indirect routes between Australia and the mainland US, although the ACCC considers that these are not close substitutes for direct services for many passengers and therefore are unlikely to represent a constraint on these routes

- airlines tend to make decisions about scheduling with regard to its impact on their broader network. A decision to coordinate on one route may cause disruptions elsewhere in their network, which may make such decisions difficult or costly to execute in practice
  - the lumpiness, costs and long lead times of aircraft purchases, and the difficulty of knowing where a competitor is likely to deploy any new aircraft in its network.
186. In the context of the factors that affect the likelihood of coordination, the ACCC considers that the Proposed Conduct creates a stronger competitor and that the single integrated network enabled by the Alliance is likely to allow the Applicants to compete more effectively with other carriers on the trans-Pacific.
187. At the same time, however, the Proposed Conduct creates greater symmetry between the operations of the Alliance and Virgin-Delta (in particular) on routes between Australia and the mainland US. The ACCC considers that this makes it more likely that these competitors would have incentives to tacitly coordinate on prices and/or capacity on these routes. However, the ACCC also notes that the number of airlines operating on the trans-Pacific is likely to be the same, with or without the Proposed Conduct.
188. The ACCC notes that the Alliance has increased capacity on trans-Pacific routes since authorisation was first granted. The ACCC also notes the recent activities of airlines on the trans-Pacific are more suggestive of competitive behaviour than coordinated conduct. Examples include (but are not limited to):<sup>32</sup>
- **Qantas' response to cessation of Melbourne – Los Angeles:** when Virgin Australia announced in July 2014 that it would cease its Melbourne – Los Angeles service in order to increase capacity on the Brisbane – Los Angeles service, Qantas responded by increasing its Melbourne - Los Angeles services from daily to ten services per week in August 2014
  - **United's entry into Melbourne - Los Angeles:** United commenced operations on the route on October 2014 (six weekly services), and boosted the frequency of its service to daily flights in March 2015
  - **Qantas' mid-2014 capacity increase:** Qantas increased its weekly capacity on the Sydney-Dallas/Fort Worth route by approximately 10 per cent
  - **United's product upgrade:** in March 2014, United replaced its Boeing 747 flights from Sydney to Los Angeles and Sydney to San Francisco with Boeing 777s.
189. The ACCC also notes the announcements that have been made since the Applicants sought re-authorisation as set out at paragraph 152.
190. The ACCC considers that the nature and timing of these events are more consistent with competitive interaction rather than coordinated conduct.
191. Nevertheless, overall, the ACCC considers that the changes resulting from the Alliance mean that there is likely to be some increased risk of coordinated

<sup>32</sup> Virgin and Delta also provided examples of competitor activities for the wider set of airlines that do not operate direct services between Australia and the US mainland.

conduct occurring in relation to price and capacity on trans-Pacific air passenger services over the longer term, and this would constitute a public detriment. However, the extent of the public detriment arising from any increased risk of coordinated conduct is uncertain, and unlikely to be significant.

### **ACCC conclusion on public detriments**

192. The ACCC considers that the Proposed Conduct is not likely to increase the risk of unilateral effects but there is likely to be some increased risk of coordinated conduct on trans-Pacific air passenger services.
193. However, the ACCC also considers that while there may be a small increase in the risk of coordinated conduct on trans-Pacific services, it is unlikely to result in any significant public detriment.

### **Balance of public benefit and detriment**

194. 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.
195. The ACCC considers that the Proposed Conduct would, or would be likely, to result in:
- material public benefits in the form of enhanced products and services including new frequencies and destinations, increased and better online connections, better scheduling, greater loyalty program benefits and improved lounge access
  - material public benefits in the form of the promotion of competition in the supply of trans-Pacific air passenger transport services
  - small public benefits in the form of cost savings and efficiencies
  - potential public benefits in the form of stimulation of tourism and trade.
196. ACCC considers that the Proposed Conduct is unlikely to result in any significant detriment in any relevant area of competition.
197. For the reasons outlined in this determination the ACCC is 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.
198. Accordingly, the ACCC has decided to grant authorisation.

### **Length of authorisation**

199. The CCA allows the ACCC to grant authorisation for a limited period of time.<sup>33</sup> This enables the ACCC to be in a position to be satisfied that the likely public benefits will outweigh the detriment for the period of authorisation. It also enables

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<sup>33</sup> Subsection 91(1).

the ACCC to review the authorisation, and the public benefits and detriments that have resulted, after an appropriate period.

200. In this instance, the Applicants seek authorisation for 10 years. The Applicants submit that this time frame aligns with the initial term of the commercial agreements and is appropriate in circumstances where identified detriments are very limited and public benefits clear.
201. However, in light of the ongoing evolution of services on the trans-Pacific, and the dynamic nature of the aviation industry, the ACCC considers it appropriate to review developments on the trans-Pacific earlier than the requested 10 years.
202. As such, the ACCC has decided to grant authorisation for five years.

## Determination

### The applications

203. Application A91502 – A91503 was made using a Form FC, under subsection 91C(1) of the CCA. Authorisation is sought by the Applicants to continue to coordinate their operations between and within Australia/New Zealand and the US, Canada and Mexico pursuant to a Restated Joint Business Agreement (**Restated JBA**) and associated agreements<sup>34</sup> (the **Proposed Conduct**), for a period of 10 years.
204. The Restated JBA and associated agreements provide for coordination in respect of:
- marketing and sales
  - freight
  - pricing
  - scheduling
  - distribution strategies including agency arrangements
  - yield and inventory management
  - frequent flyer programs
  - lounges
  - joint procurement and product and service standards.
205. Re-authorisation was sought as the Proposed Conduct concerns agreements that may contain a cartel provision, a provision which may have the purpose or effect of substantially lessening competition or an exclusionary provision within the meaning of section 45 of the CCA.

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<sup>34</sup> Amendment No 5 to the Joint Business Agreement, an Alliance Agreement, an Alliance Settlement Agreement and a Codeshare Agreement

## The net public benefit test

206. For the reasons outlined in this determination the ACCC is satisfied, pursuant to sections 90(5A), 90(5B), 90(6) and 90(7) of the CCA, that in all the circumstances the Proposed 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.
207. For the reasons outlined in this determination the ACCC is satisfied, pursuant to section 90(8), that the Proposed 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.

## Conduct which the ACCC has decided to authorise

208. The ACCC revokes authorisations A91265 – A91266 and grants authorisation A91502 – A91503 to enable the Applicants to continue to coordinate their operations between and within Australia/New Zealand and the US, Canada and Mexico pursuant to, and thereby give effect to, a Restated Joint Business Agreement (**Restated JBA**) and associated agreements.<sup>35</sup>
209. The Restated JBA and associated agreements provide for coordination in respect of:
- marketing and sales
  - freight
  - pricing
  - scheduling
  - distribution strategies including agency arrangements
  - yield and inventory management
  - frequent flyer programs
  - lounges
  - joint procurement and product and service standards.
210. The ACCC grants authorisation A91502 – A91503 until 18 March 2021.
211. This determination is made on 25 February 2016.

## Interim authorisation

212. At the time of lodging the application, Qantas and American Airlines requested interim authorisation to implement the Proposed Conduct. The ACCC granted interim authorisation under subsection 91(2) of the CCA on 9 July 2015.

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<sup>35</sup> Amendment No 5 to the Joint Business Agreement, an Alliance Agreement, an Alliance Settlement Agreement and a Codeshare Agreement

213. Interim authorisation will remain in place until the date the ACCC's final determination comes into effect or until the ACCC decides to revoke interim authorisation.

### **Date authorisation comes into effect**

214. This determination is made on 25 February 2016. If no application for review of the determination is made to the Australian Competition Tribunal (the Tribunal), it will come into force on 18 March 2016.

## Attachment A - Public benefit tests in CCA

**Subsections 90(5A) and 90(5B)** provide 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(6) and 90(7)** state 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.