

QANTAS - EMIRATES: MASTER COORDINATION AGREEMENT

Reason for this briefing	To seek your authorisation of a Master Coordination Agreement between Qantas and Emirates.
Action required	Authorise the Master Coordination Agreement
Deadline	As soon as possible
Reason for Deadline	The Australian Competition and Consumer Commission authorised the Agreement on 27 March 2013 and the parties have begun implementing the alliance on routes other than the trans-Tasman from 1 April 2013.

Contact for telephone discussion (if required)

Name	Position	Telephone		First Contact
		Direct Line	After Hours	
[REDACTED]	Principal Adviser	[REDACTED]	[REDACTED]	✓
[REDACTED]	General Manager	[REDACTED]	[REDACTED]	

MINISTER'S COMMENTS:

Date:	3 April 2013	Briefing Number:	OC01553
Attention:	Hon Gerry Brownlee (Minister of Transport)	Security level:	In-Confidence

Minister of Transport's office actions

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|--|--|---|
| <input type="checkbox"/> <i>Noted</i> | <input type="checkbox"/> <i>Seen</i> | <input type="checkbox"/> <i>Approved</i> |
| <input type="checkbox"/> <i>Needs change</i> | <input type="checkbox"/> <i>Referred to</i> | |
| <input type="checkbox"/> <i>Withdrawn</i> | <input type="checkbox"/> <i>Not seen by Minister</i> | <input type="checkbox"/> <i>Overtaken by events</i> |

Background

1. This report summarises our advice regarding an application by Qantas and Emirates seeking authorisation under the Civil Aviation Act 1990 of a proposed 'Master Coordination Agreement' (the Agreement) which they have entered into.
2. You (or the Secretary for Transport under delegation) are the authorising authority for international aviation agreements. The effect of authorisation is to exempt the arrangements from the Commerce Act 1986. Without authorisation the parties would not be able to fully implement the alliance on trans-Tasman routes.
3. The Agreement also requires authorisation in Australia. The Australian Competition and Consumer Commission authorised the Agreement on 27 March 2013 for a period of five years, and subject to a condition that capacity be maintained on the four routes on which both carriers operate.
4. Our full analysis, along with the Agreement and the airlines' application, is attached to this report.

The Proposal

5. On 7 September 2012, Qantas and Emirates applied for authorisation of the Agreement. The alliance between Qantas and Emirates set out in the Agreement will involve cooperation on passenger and freight operations across their networks.
6. The Agreement provides for wide ranging cooperation involving [REDACTED] on 'trunk routes' (for Qantas services to and through Dubai and for Emirates services from Dubai to Australia and beyond (including New Zealand)), and code-sharing and interlining more broadly across the airline networks.
7. The Agreement provides for the applicants to coordinate broadly across their passenger and cargo transport operations, including in relation to:
 - planning, scheduling, operating and capacity
 - sales, marketing, advertising, promotion and distribution strategies;
 - reservation priority and pricing (including fares, rebates, incentives and discounts), for passengers, freight customers and agents
 - connectivity and integration of certain routes
 - code-share and interline arrangements
 - control of inventories and yield management functions
 - frequent flyer programs
 - all passenger-related aspects to provide a superior, consistent level of service to customers including ground services and lounge access
 - harmonising service and product standards in order to provide a seamless product to passengers
 - harmonising IT systems
 - joint airport facilities
 - potentially joint offices for sales activities
 - potentially other aspects of operations including ground handling;
 - catering, joint procurement and flight operations
 - where appropriate and mutually agreed, making joint submissions to authorities on operational matters

- services and activities that are required to facilitate any of the matters referred to above.

Statutory Criteria

8. The airlines have sought authorisation of the proposal under section 88 of the Civil Aviation Act.
9. The Civil Aviation Act does not provide that any or all agreements may be authorised but only that provisions of agreements may be authorised so far as they relate “whether directly or indirectly, to the fixing of tariffs, the application of tariffs, or the fixing of capacity, or any combination thereof”.
10. Drawing on our analysis and precedent we have concluded that the provisions of the Agreement fall within the scope of section 88(2) of the Civil Aviation Act except for clauses 10.1 (a), (b), (e) and (f) which relate to ground handling, catering, engineering services and procurement. The airlines have agreed not to seek your authorisation of these provisions.
11. The Civil Aviation Act sets out certain prohibitions – circumstances under which you may not authorise arrangements. The proposal does not fall foul of any of the prohibitions in section 88(3) or (4) of the Civil Aviation Act, and is therefore capable of being authorised. Our full analysis of this is set out in the attached report.
12. In light of this, approval of the alliance is at your discretion, to be exercised in the public interest. The public interest involves weighing up the balance between the benefits from the alliance and any potential detriments.

Benefits

13. The alliance is a manifestation of changes in global aviation over recent times. End point carriers such as Qantas have found it increasingly difficult to compete with mid point carriers such as Emirates with their geographic and cost advantages and are looking to integrated alliances to maintain and expand depth and breadth in their networks. Similar issues underlay Air New Zealand's decision to enter into an alliance with Cathay Pacific.
14. By allowing Qantas to deepen and broaden its network while continuing to manage costs, the alliance would help maintain a strong competitive dynamic between Qantas and its alliance partners on the one hand and Air New Zealand and its alliance partners on the other hand. Competition between two strong home carriers is important for the Australasian aviation market.
15. The alliance would give travellers and traders (both in and outside of New Zealand) increased access to Emirates vast and growing global network. This will benefit both the individual travellers and businesses, but more broadly will increase New Zealand's connectivity to the growing Middle East region and beyond, including to Europe and Africa. This will benefit New Zealand trade and tourism.
16. The alliance would provide some travellers with improved benefits through the ability to earn and redeem frequent flyer points and access premium services (such as lounge access).

Detriments

17. We have assessed that in most regions there will be no reduction in competition and New Zealand will benefit from increased connectivity to Emirates global network.
18. There will be a change of competitive dynamic on the four trans-Tasman routes on which both Qantas and Emirates currently operate, with a reduction in independent decision making about scheduling and pricing. On balance we consider that risks around this can be managed or mitigated by:
 - continued competition from Air New Zealand and Virgin Australia (which currently operate under an alliance on trans-Tasman routes)
 - the threat of entry from other airlines if prices were to rise
 - a five year duration for approval which will both allow an assessment of the impact of the alliance and incentivise the applicants to ensure that benefits are delivered
 - capacity conditions imposed by the Australian Competition and Consumer Commission which mean that the applicants can not reduce capacity below current levels. This effectively limits the applicants' ability to increase prices.

Conditions

19. We do not propose that conditions be applied in New Zealand for the following reasons:

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- Imposing the same conditions as part of any New Zealand approval as the Australia Competition and Consumer Commission has put in place would have no practical effect (as the airlines would have to meet them in any case) but would increase compliance costs.
- Imposing different and potentially conflicting conditions could have unpredictable consequences as the two sets of conditions interplayed.
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Christchurch Airport Proposal

20. Christchurch Airport had proposed that conditions be imposed requiring Qantas to maintain a “red tail” Qantas service (as opposed to a Jetstar service) and that a [REDACTED] increase in capacity to Christchurch be required of the airlines in the first year of the alliance. Since the Australian Competition and Consumer Commission decision (in which the conditions were across the overlapping routes on the Tasman, and not specific to Christchurch), Christchurch Airport has raised the issue of a condition relating to a red tail service further with officials and written to you on the matter.
21. [REDACTED]
22. We agree with Christchurch Airport that a Qantas mainline service offering connections to other Qantas services and a premium product (baggage transfer, business class and associated services) offers benefits to the South Island. However given the timing of the Qantas and Emirates services into Sydney and the services they connect to we do not put as much weight on this as Christchurch Airport.
23. Qantas operates from Sydney to Christchurch daily, departing at 7:15 am and arriving at 12:25 pm. Westbound, the Qantas Christchurch to Sydney service departs at 1:25 pm and arrives at 2:50pm. Qantas flights to Bangkok, Hong Kong, Jakarta, Los Angeles, Manila and Shanghai, for example, all depart Sydney in the morning or early afternoon (before passengers travelling to Sydney from Christchurch on Qantas would arrive). Jetstar operates a three times per week, early morning, service from Christchurch arriving in Sydney just after 8:00 am, but does not offer full baggage transfer or other related services for connecting Qantas departures.
24. We note that the Australian Competition and Consumer Commission, following extensive discussions with Christchurch Airport, was not convinced that the alliance between Qantas and Emirates would make it significantly more likely that the Qantas service would be replaced by a Jetstar service. Our view is that the alliance may lead to scheduling and aircraft changes by the two airline groups but that the nature of these are uncertain.
25. In our view a condition relating to a “red tail” service which would, in effect, be specifying which aircraft the Qantas Group should operate on a particular service, is overly prescriptive in the context of considering this alliance.
26. In terms of the capacity growth factor proposed by Christchurch Airport we do not consider that this is justified at this stage. [REDACTED] Qantas had a load factor (percentage of seats occupied) of [REDACTED] percent on its Christchurch – Sydney services and Emirates had a load factor of [REDACTED] percent. [REDACTED] these figures do not suggest that a large regulated increase in capacity is justified.

Duration

27. Following discussions between officials and Qantas, Qantas and Emirates have agreed to a side letter that they will apply for reauthorisation of the Agreement in New Zealand at the same time as in Australia (ie in five years time).

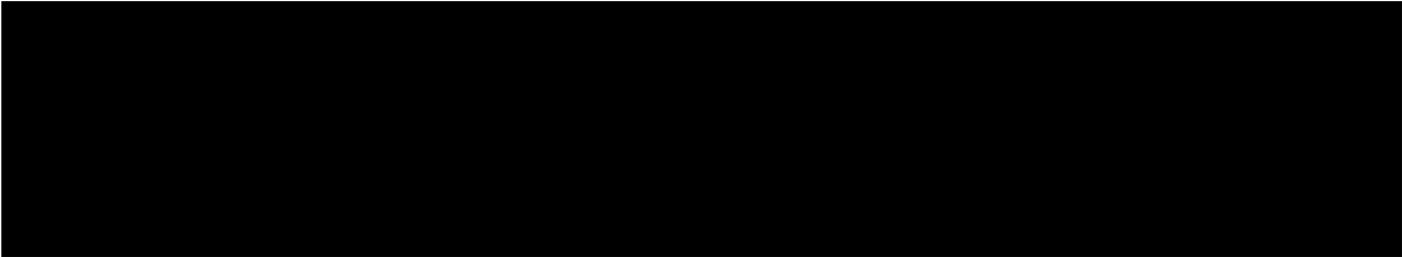
Conclusion

28. While there will be some consolidation of market power on trans-Tasman routes, we consider that the benefits of the Alliance outweigh the detriments.

Recommendations

29. The recommendation is that you:

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| (a) | Authorise, pursuant to section 88 (2) of the Civil Aviation Act 1990, the Master Coordination Agreement between Qantas Airways Limited and Emirates dated 6 September 2012 (except for sub-clauses 10.1 (a), (b), (e) and (f)) and the side letter between Qantas and Emirates dated 26 March 2013 so far as they relate to tariffs and capacity. | Yes/No |
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MINISTER'S SIGNATURE:

DATE: