

CCCS GUIDANCE NOTE FOR AIRLINE ALLIANCE AGREEMENTS

BACKGROUND

1. The aviation industry is an important pillar of the Singapore economy, contributing to value-add and job creation not only for the aviation sector but also for related sectors such as the retail and hotel industries. The economic value generated by the aviation industry of approximately \$7 billion today is also far-reaching, with the connections created between cities and markets representing an important form of infrastructure that generates benefits by facilitating trade, foreign direct investment, and tourism. As regional economies push towards deeper economic integration, enhancing connectivity through open skies agreements to generate free and open competition in the aviation sector, become increasingly important. Correspondingly, competition assessment is a pertinent component of open skies agreements.

2. There are strong incentives for mergers and alliances between airlines, as these can allow the airlines to lower costs and compete better by enhancing demand for their services through rationalising hub-and-spoke structures, achieving greater cost efficiencies and offering a larger range of connections. While the scope and nature of these alliances differ, some airline alliances involve a deeper level of cooperation and are akin to mergers. This raises conflicting issues, as such alliances have the potential to both enhance operational efficiencies and the quality of air services to consumers, yet at the same time may significantly restrict competition.

3. Airline alliance agreements are, in many cases, notified to CCCS for a decision on whether the agreement has infringed the section 34 prohibition¹ and in particular, whether the agreement benefits from the net economic benefit (“NEB”) exclusion under section 35 read with paragraph 9 of the Third Schedule to the Competition Act. In view of the increasing number of airline alliance agreements notified to CCCS for decision, CCCS has published this guidance note with a focus on the aviation industry in order to better assist airlines in considering their notification to CCCS. It is designed as a short introductory guide, supported by CCCS’s published guidelines setting out in detail CCCS’s assessment of agreements under section 34 of the Act and procedures and processes in relation to filing a notification for guidance (“NG”) or decision (“ND”).

¹ Section 34 of the Act prohibits agreements between undertakings, decisions by associations of undertakings or concerted practices which have as their object or effect the prevention, restriction or distortion of competition within Singapore unless they are excluded or exempt in accordance with the provisions of Part III of the Act (“the Section 34 prohibition”).

4. Specifically, the guidance note provides details on issues including:
- (i) when should airlines file a notification in relation to their alliance agreements;
 - (ii) the availability of a pre-notification discussion to assist the filing of a notification;
 - (iii) the basic information which CCCS would require, for example, the overlapping routes, market share information, example of proposed changes in flight schedules, market entries and exits, etc.;
 - (iv) CCCS's processes i.e. issuing a media release for a public consultation on the notification, information requests to the airlines and third-parties including Government agencies, competitors and customers;
 - (v) the option to request state-of-play meetings during the assessment;
 - (vi) the option to offer commitments to address any specific competition concerns arising from the agreement and the types of acceptable commitments;
 - (vii) the option to request for a streamlined process for the assessment of airline alliance agreements that fall within the streamlined process framework; and
 - (viii) some of the common issues faced by parties and CCCS in the assessment, for example in relation to factors considered by CCCS under the NEB test specific to airlines joint venture agreements.

5. In relation to the common issues faced by parties and CCCS during the assessment of airline alliance agreements, the guidance note provides information on CCCS's approach for such issues going forward which may differ from CCCS' current approach. However, CCCS may deviate from the stated approaches where relevant and necessary, depending on the facts of the case.

PROCEDURAL MATTERS

6. Section 34 of the Competition Act (Chapter 50B) ("the Act") prohibits agreements, decisions by associations of undertakings and concerted practices which have the object or effect of preventing, restricting or distorting competition in Singapore. An infringement of section 34 of the Act can result in the imposition of financial penalties by CCCS.

7. As regards the aviation industry, airline(s) may apply to CCCS on a purely voluntary basis for:

- (i) Guidance under section 43 of the Act as to whether, in CCCS's view, an agreement to which the airline(s) is a party is likely to infringe the section 34 prohibition, whether the agreement is likely to fall under a block exemption or is excluded from the ambit of the Act; and

- (ii) Decision under section 44 of the Act as to whether the agreement has infringed the section 34 prohibition.

Self-Assessment

8. Competition concerns may arise from an alliance agreement where the airlines intend to cooperate on pricing, capacity and/or frequency of flights, amongst others. However, there have been instances in which airlines have notified their agreement(s) to CCCS even though the competition concerns were remote. For example, if the airlines do not operate on the same routes and are unlikely to overlap in the foreseeable future, there would be no change to the level of competition before and after the agreement.

9. On routes where the airlines overlap, they may have low market shares which indicate that the rivalry between the airlines is low and the airlines would continue to be subject to intense competition by competitor airlines after the agreement. An airline alliance agreement will generally have no appreciable adverse effect on competition if the aggregate market shares of the parties to the agreement do not exceed 20% on any of the routes affected by the agreement, and parties may consider not making a notification to CCCS. This 20% market share threshold is only applicable for airline joint ventures that generate operational efficiencies, and does not apply to hardcore cartel agreements between airlines (for example, to fix prices) that are detrimental to consumers without any corresponding efficiencies. Airlines may also consider passenger volumes as a screening factor for notification. For example, the passenger volumes on the overlapping routes may be insignificant and the agreement's impact on competition may be limited. It may not be necessary to notify CCS of agreements relating to such routes in some cases, depending on the facts of the case. CCCS will generally take no further action once a decision or guidance has been given that the Section 34 prohibition has not been infringed unless there is a material change of circumstance. For those alliance agreements or parts thereof that are not notified to CCCS, CCCS reserves the right to investigate the cooperation on these routes after the alliance agreement has taken place. Therefore, the airlines should be reasonably assured from their self-assessment that their cooperation on these routes will not pose a competition concern. Parties may choose to submit their self-assessment to CCCS in order to support their case, in the event of a notification or an investigation. Besides, while parties may submit the decision or relevant papers of an overseas jurisdiction for CCCS's consideration of their case, CCCS has to look at the market-specific evidence for Singapore as the considerations including the market structure and competition dynamics may differ across jurisdictions.

10. Screening factors that airlines should consider when deciding whether to notify the agreement to CCCS or to narrow the scope of the notification to CCCS, include factors such as:

- (i) whether the parties have overlapping routes;

- (ii) market shares as an indicator of the closeness of rivalry; and
- (iii) passenger volumes to determine the impact on competition.

11. In particular, code-share and interline agreements are generally on a lower level of cooperation and generally need not be notified to CCCS unless the agreements touch on issues such as coordination on pricing, schedule or capacity.

Availability of a pre-notification discussion to assist the filing of a notification

12. Airlines intending to apply for guidance or a decision from CCCS on whether an agreement is likely to infringe, or has infringed, the section 34 prohibition are encouraged to contact CCCS at an early opportunity to discuss the content and timing of their notifications. These discussions are generally referred to as Pre-Notifications Discussions (“PNDs”). Such PNDs can be arranged with CCCS by calls to the CCCS hotline at 1800-325-8282 or by email to cccs_feedback@cccs.gov.sg. PNDs are not intended to relate to purely speculative or hypothetical agreements. At the point when airlines approach CCCS for PNDs, they should be able to show that there is a good faith intention to proceed with the agreement.

13. PNDs may be informal and brief or more formal and detailed, depending on the preferences of the potential applicants, the complexity of the agreement in question, and the competition concerns that the agreement may raise. Such PNDs would be more fruitful if potential applicants provide CCCS with a draft version of CCCS’s Form 1, which lists the information and supporting documents which must be provided when applications for guidance or decision are made, prior to a PND. During a PND, CCCS will highlight any gaps in the information provided in the draft Form 1, which can expedite the issuance of CCCS’s guidance or decision by minimising the risk that the notification will be deemed incomplete.

Basic information to be submitted in the notification

14. As stated above, the information that must be submitted in a notification to CCCS for guidance or a decision is set out at Appendix A (also known as Form 1) of the *CCCS Guidelines on Filing Notifications for Guidance or Decision with respect to the Section 34 Prohibition and Section 47 Prohibition 2016* (“Notification Guidelines”), which are accessible on CCCS’s website. Form 1 requires information relating to, amongst other things: the purpose of the application; the identities of the applicant and the other parties to the agreement or conduct; the relevant product and geographic markets; and details of the agreement and conduct. In addition, data that would be required for CCCS’s assessment such as market share figures should also be provided.

State-of-play meetings

15. The time taken by CCCS to furnish guidance or decisions will depend on the nature and complexity of the application, as well as the volume of applications that has

been filed with CCCS at that time. Airlines may request for state-of-play meetings with CCCS at any time during the course of the assessment of the application for an indication as to when an outcome can be expected. Substantive matters faced in the assessment of the airline alliance agreement, may also be discussed at such state-of-play meetings.

Offering of commitments

16. If CCCS identifies competition concerns arising from an agreement, the airlines may offer voluntary commitments to CCCS to address the competition concerns. For example, the airlines could commit to carry a minimum number of Singapore passengers on a given route in each calendar year, to increase seat capacity by a certain number, etc. depending on the specific concerns. If the commitments are sufficient in addressing the competition concerns identified by CCCS, they will be accepted by CCCS by way of a conditional clearance decision.

Streamlined process

Purpose

17. CCCS is considering the adoption of a streamlined process for assessments relevant to the aviation sector, in response to feedback from the aviation sector on its specific needs. The streamlined process is designed to provide quicker decisions by CCCS and minimum costs to airlines.

Indicative Timeframe

18. Under the streamlined process, CCCS intends to issue a decision or guidance within seven months. The process will encompass a two-phase approach, with a Phase 1 review expected to be completed within 30 working days for simple cases, plus an additional Phase 2 review of 120 working days for complicated cases.² A Phase 1 review entails a quick assessment and allows CCCS to give a favourable decision or guidance with regard to airline agreements that clearly do not raise competition concerns. To achieve the seven-month timeline, full cooperation of the airlines must be provided throughout the process. Airlines must provide complete, concise and relevant information promptly and within the timeframes specified. This total timeline of 150 working days is the maximum duration that CCCS will take to assess the airline alliance agreement, and Phase 1 allows for quick clearance if it is not problematic. The airline alliance agreement may also be cleared with commitments between Phase 1 and 2. In the past 13 NDs that CCCS had assessed in relation to airline alliance agreements, an average of 164 working days was used for CCCS's assessment, but CCCS took fewer than 164 working days in 8 out of 13 NDs.³ As such, the 150 working-day timeline for the streamlined process is a reasonable one based on past experience.

² 150 working days in total, which is approximately seven calendar months.

³ Ranging from 91 to 142 working days, except for the strategic alliance between Singapore Airlines Limited and Air New Zealand Limited, for which CCCS took 55 working days for its assessment.

19. Application for the streamlined process must be made in writing with supporting documents, together with the submission of Form 1 accompanied by the appropriate initial fee.⁴ The 30 working day indicative timeframe for Phase 1 review will commence, after CCCS deems that Form 1 is complete ***and*** the airline alliance agreement in question qualifies for the streamlined process. CCCS endeavours to respond within five working days as to whether the application can be considered under the streamlined process, subject to the airlines' provision of adequate information that allows for the assessment of their request for the streamlined process. If it is necessary to proceed to a Phase 2 review in the streamlined process, CCCS will inform the airlines in writing to submit Form 2 together with the appropriate further fee.⁵ The airlines will be informed of this no later than the Terminal Date of the Phase 1 review. The 120 working day indicative timeframe commences when CCS deems that Form 2 is complete.

Framework for considering when the streamlined process may be appropriate

20. To reach a decision on whether the streamlined process may be appropriate to any given application, a number of factors will be considered in making the assessment, including the following:

- (i) Lodging the application earlier was not a viable option, hence necessitating the request for urgent assessment⁶;
- (ii) If the agreement was assessed under CCCS's standard ND/NG procedures outside of the streamlined process, irreparable harm would occur to the business of the parties;
- (iii) Rejection of the request for urgent assessment would negate the possibility of any net economic benefits or efficiencies accruing to Singapore;
- (iv) Urgent assessment by the CCCS is feasible (e.g. for cases where competition assessment is not exceptionally complicated), facilitated by documents and information provided by the Parties; and/or
- (v) There is broad consensus of interested parties, which could include governmental agencies and/or consumer group representatives, in favour of the agreement.

21. The above list of factors is not exhaustive, nor prescriptive. It should further be noted that not all requirements need to be fulfilled in order for the streamlined process to be deemed appropriate.

22. CCCS will consider submissions from airlines that fall outside of the above list of factors, but such submissions must provide a justification as to why the streamlined

⁴ S\$3,000 for Notification for Guidance, S\$5,000 for Notification for Decision.

⁵ S\$20,000 for Notification for Guidance, S\$40,000 for Notification for Decision.

⁶ For instance, airlines may not be able to conclude on the terms of agreement until the stage where conclusion of the agreement becomes critical for the financially distressed airline.

process may be appropriate in a given case. Separately, and as stated above, CCCS is open to having PNDs with the airlines, during which the airlines may wish to provide submissions on why the streamlined process may be appropriate, and any evidence in support of these submissions. For example, airlines may raise the likely business failure of one of the parties with supporting evidence as a reason why the streamlined process is appropriate.

Stopping the clock

23. While the streamlined process is intended for faster assessment and decision-making on the part of CCCS, a balance needs to be struck against this and the robustness of CCCS's analysis and conclusions.

24. In this regard, CCCS may from time to time ask the airlines to provide additional information. In situations where the airlines are unable to provide the information within the stipulated timeframe, this may necessitate a "clock-stoppage" mechanism as part of the streamlined process, thereby extending the indicative timeframe for completion of the streamlined process. In both Phase 1 and Phase 2 of the streamlined process, commitments may also be proposed by the airlines as a suitable remedy to address any identified competition concerns. In cases where there is a need to accommodate the commitments procedure, including the need to consult with third parties on any proposed commitments, it may also be necessary for CCCS to "stop the clock".

Review of the streamlined process

25. During the course of its assessment under the streamlined process, CCCS will keep under review whether the streamlined process remains appropriate. Should CCCS decide that the streamlined process is no longer appropriate, the airlines to the notification will be informed of the reasons for this decision. The airlines may in response provide submissions and further evidence on why the streamlined process remains appropriate. Alternatively, the airlines will have the option of continuing the notification under the standard ND/NG process.

26. Similarly, during the course of its assessment under the standard ND/NG process, CCCS may deem it appropriate to consider the application under the streamlined process, and will inform the airlines if this is the case.

SUBSTANTIVE MATTERS

Route-by-route approach to market definition

CCCS's Approach

27. CCCS takes the starting point for market definition relating to the provision of scheduled air passenger services for airline alliances to be the origin-destination (“OD”) city pair route. This is because passengers generally want to travel to a specific destination and will not substitute another destination when faced with a small but significant increase in price. Therefore, each combination of a city of origin and a city of destination can form a distinct market. This approach for market definition is consistent with the approach in overseas jurisdictions.

28. In the assessment of efficiency claims under the Net Economic Benefit (“NEB”) exclusion, CCCS currently takes a strict approach that any benefits need to offset or mitigate the competition concerns from the problematic route.

29. CCCS is of the view that, from a passenger’s point of view, competition assessment should still be carried out on a route-by-route basis. However, there may be merit in adopting a network approach where appropriate when assessing NEB for airline alliance agreements. This is because CCCS adopts a total welfare approach which considers the overall economic benefits to Singapore. Harm to a particular group may be tolerable if the overall economic benefits to Singapore outweigh the overall harm.

30. In this regard, the CCCS Guidelines on the Section 34 Prohibition provides for CCCS to consider efficiencies generated in separate markets for the assessment of NEB. Paragraph 10.1 of the section 34 Guidelines states that:

In general, the assessment of benefits flowing from agreements would be made within the confines of each relevant market to which the agreements relate. However, where two (or more) markets are closely related, efficiencies generated in these separate markets may be taken into account

31. Paragraph 10.1 suggests that benefits generated from other “*closely related*” OD routes due to the alliance can be used to assess if limb 1 of the NEB assessment is satisfied. In this regard, CCCS will consider if OD routes under the alliance but not where competition concerns are identified, in particular feeder routes, may be considered as “*closely related markets*”. This would be the case if, for instance, an increase in passenger numbers from a feeder route due to the alliance can result in the airlines being able to carry OD passengers on a trunk route at lower costs under the alliance. For example, an increase in passenger count on the Singapore-Sydney route due to the airline alliance agreement can result in the parties being able to channel more transit passengers to the Singapore-Zurich route, and vice versa. In addition to complementary OD routes, OD routes within the alliance that are substitutes for each other may also be considered as “*closely related markets*”. This would be the case if a

decrease in passenger numbers for a particular OD route due to passengers switching to other substitute OD routes can benefit passengers on the first OD route via better seat availability. For example, an increase in flight frequency for the Singapore-Zurich route may result in better seat availability for the Singapore-Munich route, as passengers who used to fly on the Singapore-Munich route may choose to fly from Singapore to Munich indirectly via Zurich, given the increase in flight frequency.

Information required

32. The onus is on the airlines claiming that the NEB exclusion applies, to provide sufficient information to demonstrate the claimed benefits. Information that will be helpful for CCCS's assessment includes internal business reports or external market research/consultancy reports showing quantifiable benefits arising from the alliance for specific routes flowing to other routes, or actual benefits (e.g. passenger numbers, frequency, prices) from comparable past alliances flowing to other routes.

Differentiated Products/Services

33. In some of CCCS's previous notifications, airlines had submitted that differentiated products/services (e.g., indirect flights, low-cost carrier vs full-service airlines, other mode of transport etc.) may compete within the same relevant market (i.e. OD routes) as direct full-service flights. In particular, parties often submit that indirect flights of competitors compete closely with them on direct routes.

CCCS's Approach

34. CCCS considers if differentiated products/services fall within the same relevant market based on the facts of each individual case. For example, if evidence shows that there are many passengers who take one-stop flights in place of the direct flights for the specific OD route, then CCCS will consider these one-stop flights to be within the relevant market. Similar approaches have been considered by competition authorities overseas. Currently, CCCS first defines the relevant market before conducting a market share analysis to assess whether the differentiated products compete within the same relevant market.

35. In general, market power is more likely to exist if an airline (or group of airlines) has persistently high market shares, even after taking differentiated products into account. Relative market shares can also be important. For example, a high market share might be more indicative of market power when all other competitors have very low market shares.

36. The history of the market shares of all undertakings within the relevant market is often more informative than considering market shares at a single point in time, partly because such a snapshot might not reveal the dynamic nature of a market. Evidence that airlines with low market shares have grown rapidly to attain relatively large market

shares might suggest that barriers to expansion are low, particularly when such growth is observed for recent entrants, and vice versa.

37. CCCS will continue to use market shares as an important starting point for the assessment of differentiated products. Information helpful for CCCS when performing a market share analysis include the historical market share data for airlines, including that of airlines operating directly and indirectly on the particular OD route(s).

38. In addition to market share analysis, CCCS may consider the following additional three approaches in assessing the closeness of rivalry between differentiated products:

- (i) Price correlation analysis;
- (ii) Diversion ratio analysis;
- (iii) Stationarity analysis

Price correlation analysis

39. Price correlation measures the extent to which prices of two products move in tandem over time.⁷ The closer the movement in prices, the closer the degree of substitution between the products. A practical advantage is that it is easy to implement and it requires only price data. However, a potential problem with this technique is that prices of different products may be highly correlated because of common factors that have nothing to do with substitution, leading to spurious correlation of prices. Examples of such common factors include common fuel costs or common demand factors.

Information required

40. Information helpful for CCCS's assessment will include the "operating yield" for airlines operating on the particular OD route(s) over time. Because the operating yield is computed by dividing the operating revenues by tonne-kilometres, it will provide a common measure of 'price' for the purpose of assessing the price correlation between airlines. Information on significant external events that may have an effect on airfares (e.g. fuel cost fluctuations etc.) will also be helpful to avoid spurious correlation between prices of different products.

Diversion ratio analysis

41. A diversion ratio is a measure of the amount of switching, based on the proportion of sales that is lost to a particular substitute product, indicating the closeness of competition between two products, even if they are differentiated.

⁷ A correlation of 1 means that every movement in the price of one product is exactly reflected in the other. A correlation of -1 means every movement in the price of one is reflected by an exactly opposite movement in the other.

$$\text{Calculation: Diversion Ratio}_{AB} = \frac{\text{Sales gain for product B}}{\text{Sales loss for product A}}$$

42. In the context of the aviation industry, a high diversion ratio of flights operated by airline A to flights operated by airline B suggests that airline B will be able to capture more of airline A's lost sales, suggesting that product B is closely competing with airline A. The higher the diversion ratio, the greater the risk of an agreement between airline A and airline B giving rise to an increase in fares. The diversion ratio method has been widely used in merger analysis in determining the closeness of the merger products or services.⁸

Information required

43. Information that will be helpful for CCCS's assessment will include the "operating yield", ticket sales, as well as load factors measuring capacity utilisation and Revenue Passenger Kilometres measuring traffic volume on the particular OD route(s) over time. Information on significant external events which affect sales and fares occurring during the observed time period will also be useful.

Stationarity analysis

44. If two products compete in the same market, their price changes cannot drift too far apart since consumers will switch between them. This means that their **relative price movements** should be stable over time due to arbitrage. This consideration can be made operational by the concept of stationarity.⁹

$$\text{Calculation: } X_t = \ln \frac{P_{it}}{P_{jt}}$$

45. If relative price movements are not stationary (i.e. null hypothesis rejected with statistical significance), this implies that the two products are unlikely to compete in the same market.¹⁰

⁸ For more complicated cases, the CCCS may also carry out the Upward Pricing Pressure-Test ("UPP Test") which makes use of both the diversion ratio and gross profit margin to determine the probability of a price increase post-agreement. The UPP test is also widely used in merger analysis.

⁹ Time series are covariance stationary if their moments up to the second order do not depend on time. For instance, the mean must be constant over time. An important property of stationary series is that they frequently cross their mean and exhibit a tendency to revert to it, such that shocks affecting stationary series have only temporary effects.

Two common stationarity tests are the Augmented Dickey-Fuller (ADF) test and the KPSS test. The null hypothesis for the ADF test is non-stationarity, so that rejection indicates stationarity. In contrast, the null for the KPSS test is stationarity, so that rejection signals non-stationarity.

¹⁰ However, the reverse is not necessarily true, i.e. a failure to reject stationarity does not necessarily imply that the products compete in the same market because stationarity could still be observed even if the products are in separate distinct markets. This could happen if the prices themselves are stationary, or affected by common sources of shocks (e.g. cost shocks) during the sample period.

Information required

46. The stationarity analysis has minimal data requirements which are similar to that of the price correlation analysis.

The Counterfactual

47. Counterfactual analysis serves as a means of assessing whether a given agreement has incremental effects on competition by considering whether a realistic alternative situation in the absence of the relevant agreement would be more competitive.

CCCS's Approach

48. In most cases, the best guide to the appropriate counterfactual is the prevailing conditions of competition, as this provides a reliable indicator of competition without the agreement. However, in some cases, the status quo may not be the appropriate counterfactual. CCCS takes into account likely and imminent changes in the structure of competition, such as a failing firm, in order to reflect as accurately as possible, the nature of rivalry without the agreement or merger.

49. CCCS will consider all available evidence to decide on the relevant counterfactual. In particular, information that will be useful for CCCS's consideration of the counterfactual includes internal and external documents, such as briefing and board papers for the Board and/or Senior Management, as well as correspondence with aviation regulators, airport operators and financial institutions.

50. One counterfactual that CCCS had accepted in the past was the "failing firm" defence. In cases where one of the parties is genuinely failing, pre-existing conditions of competition might not prevail even in the absence of the agreement/merger, as the failing party may exit the market in any case. In such situations, the counterfactual might need to be adjusted to reflect the likely exit of one of the parties and the resulting loss of rivalry. In the *SIA/Tiger Airways* case, CCCS determined that the three limbs of the failing firm defence were fulfilled i.e. the counterfactual was not status quo but one where Tiger Airways would exit without the merger.

51. A similar argument can be made for "failing divisions". In the case of airline joint ventures, each OD route can be considered as a business division of the airline. The conditions for the failing OD route defence include:

The European Commission used the stationarity test to define the geographic market in the merger proceedings *Arjowiggins/M-real Zanders Reflex* (COMP/M.4513). Other examples for the application of the stationarity test are merger proceedings *Arsenal/DSP* (COMP/M.5153) and *Nordic Capital/Convatec* (COMP/M.5190).

- i. First, upon applying appropriate cost allocation rules, the OD route would have a negative cash flow on an operating basis¹¹;
- ii. Second, absent the alliance, the assets used on the route would exit the relevant market in the near future if not sold. Evidence to demonstrate the prospect of exit from the relevant route will need to be provided; and
- iii. Third, the airline of the failing OD route must also demonstrate that it has undergone careful business evaluation and explored possible options to lend credibility to the prospect of exit.

52. In addition, the assessment of net economic benefits will be carried out in the context of the appropriate counterfactual, including whether new routes or new services would have been introduced, or whether existing routes, frequency and capacity of services would have been sustained, and correspondingly, whether the benefits would have been realised in the counterfactual.

Assessment of Metal-Neutral Agreements

53. In notifications to CCCS, parties often submit that the airline joint venture agreement will not have the *effect* of appreciably preventing, restricting or distorting competition within Singapore.

CCCS's Approach

54. Airline joint venture agreements often contemplate coordination between the parties on pricing, capacity, frequency and scheduling of flights, and/or sharing of revenue according to the capacity output by each airline. Given the restrictions contained within such agreements that are akin to price-fixing and/or capacity control agreements, as a starting point, CCCS considers such "metal neutral" alliances to have the object of restricting competition. However, CCCS is cognisant that such metal neutral alliances may also generate operational efficiencies and benefits, unlike hardcore cartels that are formed for the sole purpose of restricting competition between competitors.

55. Therefore, notwithstanding the object classification of such metal-neutral alliances as a starting point, CCCS will assess their competitive effects in considering the balance of harm and benefits under the Net Economic Benefit ("NEB") test. Based on CCCS's experience, there will generally be no appreciable adverse effect on competition on the specific OD route, if the parties to a metal-neutral alliance have a combined market share that does not exceed 20% on that route. A sliding scale approach will be used to assess whether the benefits brought about by the agreement would be sufficient to outweigh the harm. In the 13 NDs that CCCS has assessed in relation to airline alliance agreements, 11 were found to have the object of restricting

¹¹ However, CCCS might need to consider whether an unprofitable route might nonetheless be sustainable on a network basis, such as serving as a feeder route.

competition¹², of which 9 were cleared because it gave rise to efficiencies that satisfied the NEB test and 2 were cleared with commitments accepted by CCCS.

Information required

56. Factors such as market shares, market power of the parties to the agreement, the content of the agreement and the structure of the market or markets affected by the agreement, such as entry conditions or the characteristics of buyers and the structure of the buyers' side of the market could be considered in determining the extent of the effects. The onus is placed on the parties to demonstrate that the claimed benefits would outweigh the competition harm. In addition, parties have to demonstrate the likelihood of the claimed benefits materialising by providing evidence such as a formal application for airport slots, formal plans to increase seat capacity on the specific OD routes etc.

Potential New Entry

57. CCCS considers that new entry and the threat of entry can pose important competitive constraints by deterring any attempt by the parties to exploit the reduction in rivalry following a merger or an agreement. If entry is easy and likely, then the mere threat of entry may be sufficient to deter parties from raising their prices, since any price increase or reduction in output or quality would incentivise new entry to take place.

CCCS's Approach

58. CCCS currently adopts an approach that for new entry (actual or threatened) to be considered a sufficient competitive constraint, three conditions must be satisfied: the entry must be likely, sufficient in extent and timely.¹³

59. CCCS would need more information to determine whether the lack of a potential entrant currently would be problematic. In a scenario where there are no potential new entrants because the current price is unprofitable, it would be necessary to seek information from the potential entrants:

- (i) on whether there are any barriers to entry (because while potential entrants might be incentivised to enter if the parties increase prices, the presence of barriers to entry will be an issue;
- (ii) on whether they would enter the market if the incumbents were to raise their prices above competitive levels; and

¹² 2 out of the 13 were not treated as object cases.

In the ND from Singapore Airlines Limited and Scandinavian Airlines Limited on their joint venture agreement, the parties did not directly operate overlapping services on the same city-pair routes although their cooperation involved revenue sharing and joint pricing/scheduling.

In the ND from Qantas Airways and British Airways on their joint services agreement, the agreement was assessed to have the appreciable effect of restricting competition on all the notified routes in any case.

¹³ To understand what constitutes likely, sufficient and timely entry, airlines may refer to the CCCS Guidelines on the Substantive Assessment of Mergers.

- (iii) at what level would they be incentivised to enter the market. If the price it takes to incentivise potential entrants to enter the market is significantly above competitive levels, then it may be the case that potential entry may not be likely and concerns should be raised on the particular route after considering all factors holistically.

Benefits to Singapore's Aviation Hub

60. Parties often submit that not only do the agreements bring benefits such as passengers numbers to Singapore, flight frequencies to Singapore and commits the parties to flying through Singapore, amongst others, the agreement will also bring about considerable benefits in relation to the strategic positioning of Singapore, and accordingly Changi Airport, as an aviation hub. This creates several direct and indirect economic benefits for Singapore.

CCCS's Approach

61. The benefit of the agreement strengthening Singapore as an aviation hub is treated as a derivation of the other benefits such as the increase in flights through Singapore, the commitment of the parties to fly through Singapore, promoting Singapore's tourism or the increase in passenger numbers. Therefore, if these other benefits have already been taken into consideration separately, then the argument about enhancing Singapore's aviation hub status may not be a separate and additional benefit.

62. In addition, CCCS may consider any multiplier or ripple effects beyond the direct economic contribution of the airline alliance agreement that can be demonstrated by the parties. Such multiplier effects may include off-airport expenditures directly related to air travel brought about by the airline alliance agreement (e.g. the travel and tourism businesses) or consumer spending induced from the additional income earned through either the direct economic activity or off-airport expenditures.

63. Therefore, if the parties are able to demonstrate a separate set of benefits that accrue incrementally for the benefit of Singapore or Changi Airport as an aviation hub, this argument may be accepted as an additional benefit.

Benefits accrued to Singapore Passengers

64. The nature of air passenger services is such that a particular route falls under the jurisdiction of Singapore where either the origin, destination or transit port is Singapore. From a demand-side point of view, a distinction can also be made between outbound passengers from Singapore ("Singapore-based passengers"), inbound passenger to Singapore, transit passengers stopping over Singapore for a stay, and connecting passengers that do not cross the Singapore border during their transit.

65. CCCS has considered whether benefits accrued to these different categories of passengers should carry different weights. For example, whether a transit passenger

crosses the Singapore border for a stay affects the extent of benefits to tourism in Singapore. From a supply-side point of view, more of such passengers would also improve the economies of scale of the flight operations on that route, which might lead to higher capacities and frequencies, as well as lower prices. Such benefits may also flow through to other types of passengers.

CCCS's Approach

66. In the *SIA/Lufthansa* case, CCCS expressed a competition concern that the increased transit traffic brought about by the alliance might result in less capacity available to Singapore-based passengers. In approving the alliance, CCCS accepted a commitment from the parties that they would commit to carrying a minimum number of Singapore-based passengers on the two routes of concern on an annual basis.

67. CCCS notes that there are situations whereby non-Singapore-based passengers are important to the business case for airlines to expand capacity on specific routes or introduce new destinations for Singapore. In such instances, CCCS may consider the benefits for Singapore-based passengers against the counterfactual where they would have failed to enjoy these benefits in the absence of the airline alliance agreement. Parties would need to provide evidence that the new routes or services were introduced largely or partially due to non-Singapore-based passengers. In the 13 NDs that CCCS has assessed in relation to airline alliance agreements, this consideration did not arise. CCCS will be open to receiving submissions on this issue where appropriate.

68. CCCS may accept any claim that the agreement may positively impact Singapore-based passengers as a benefit. In addition, benefits to non-Singapore based passengers may bring about benefits to Singapore as a whole through other means. For example, feeder traffic may reduce the unit cost for operating the trunk route, thus resulting in benefits for all types of passengers on that route.