

PUBLIC CONSULTATION ON CCS'S DRAFT GUIDANCE NOTE FOR AIRLINE ALLIANCE AGREEMENTS

22 January 2018

FOREWORD

Introduction

The Competition Commission of Singapore (“CCS”) is publishing a guidance note in relation to CCS’s assessment of airline alliance agreements to assist the airlines and their legal counsel in their self-assessments and possible notification of such agreements to CCS.

This document includes the draft guidance note for interested parties to reflect and respond to.

Responding to this consultation

CCS welcomes responses to this consultation draft from all stakeholders, including law firms, the business community, government departments as well as members of the public. Where appropriate, persons responding to this consultation should give an indication of the organisation(s) or interests they represent.

The consultation period begins on 22 January 2018 and ends on 12 February 2018.

You may wish to submit your response via our Public Consultation Online Form at <https://www.ccs.gov.sg/public-register-and-consultation/public-consultation/public-consultation-online-form>.

Alternatively, you may also write or email your response to:

- (i) Post/Courier:
Competition Commission of Singapore
45 Maxwell Road
#09-01, The URA Centre
Singapore 069118
Attention: Mr. Jonathan Chan, Assistant Director (Business & Economics)
- (ii) Email: ccs_feedback@ccs.gov.sg

It would be helpful if respondents could organise their submissions as follows:

- (i) Cover page
- (ii) Table of Contents
- (iii) Statement of Interest
- (iv) Summary of major points
- (v) Comments and responses to questions
- (vi) Conclusion

Supporting material may be annexed. All submissions should be clearly and concisely written and should provide a reasoned explanation for any proposed amendments or additions. Where feasible, respondents should identify the specific section or paragraph on which they are commenting.

In the interest of transparency, CCS proposes to publish a summary of the key comments to this consultation. Respondents may request that any part of the submission that they believe to be proprietary, confidential or commercially sensitive be kept confidential. Any such information should be clearly marked. Where CCS agrees with the request, it will consider the information but will not publicly disclose it. If CCS rejects the request, it will not consider the information and will return the information to the respondent. As far as possible, respondents should limit any request for confidential treatment of information submitted. CCS will not accept any submission that requests confidential treatment of all, or a substantial part of the submission.

Next Steps

Following this consultation, CCS will review the responses provided and take them into account in considering the amendments to be made to the draft guidance note.

CCS DRAFT 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 CCS 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 CCS for decision, CCS has published this guidance note with a focus on the aviation industry in order to better assist airlines in considering their notification to CCS. It is designed as a short introductory guide, supported by CCS’s published guidelines setting out in detail CCS’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”).

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;

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”).

- (iii) the basic information which CCS would require, for example, the overlapping routes, market share information, example of proposed changes in flight schedules, market entries and exits, etc.;
- (iv) CCS'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 satisfy the framework of factors; and
- (viii) some of the common issues faced by parties and CCS in the assessment, for example in relation to factors considered by CCS under the NEB test specific to airlines joint venture agreements.

5. In relation to the common issues faced by parties and CCS during the assessment of airline alliance agreements, the guidance note provides information on CCS's approach for such issues going forward which may differ from CCS' current approach. However, CCS 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 CCS.

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

- (i) Guidance under section 43 of the Act as to whether, in CCS’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 CCS 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. It may not be necessary to notify CCS of agreements relating to such routes in some cases, depending on the facts of the case. CCS 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 CCS, CCS 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.

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

- (i) whether the parties have overlapping routes; and
- (ii) market shares to determine the close of rivalry

11. In particular, code-share and interline agreements are generally on a lower level of cooperation and generally need not be notified to CCS 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 CCS on whether an agreement is likely to infringe, or has infringed, the section 34 prohibition are encouraged to contact CCS 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 CCS by calls to the CCS hotline at 1800-325-8282 or by email to ccs_feedback@ccs.gov.sg. PNDs are not intended to relate to purely speculative or hypothetical agreements. At the point when airlines approach CCS 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 CCS with a draft version of CCS’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, CCS will highlight any gaps in the information provided in the draft Form 1, which can expedite the issuance of CCS’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 CCS for guidance or a decision is set out at Appendix A (also known as Form 1) of the *CCS 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 CCS’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 CCS’s assessment such as market share figures should also be provided.

State-of-play meetings

15. The time taken by CCS 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 CCS at that time. Airlines may request for state-of-play meetings with CCS at any time during the course of the assessment of the application for an indication as to when an outcome can be expected.

Offering of commitments

16. If CCS identifies competition concerns arising from an agreement, the airlines may offer voluntary commitments to CCS 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 CCS, they will be accepted by CCS by way of a conditional clearance decision.

Streamlined process

Purpose

17. CCS 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 CCS and minimum costs to the airlines.

Indicative Timeframe

18. Under the streamlined process, CCS intends to issue a decision or guidance within seven months. The process will be a two-phase approach, with a Phase 1 review expected to be completed within 30 days for simple cases, plus an additional Phase 2 review of 120 days for complicated cases.² A Phase 1 review entails a quick assessment and allows CCS 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.

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.³ The 30 working day indicative timeframe for Phase 1 review will commence, after CCS deems that Form 1 is complete *and* the airline alliance agreement in question qualifies for the streamlined process. CCS 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, CCS will inform the airlines in writing to submit Form 2 together with the appropriate further fee.⁴ 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.

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

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

⁴ S\$20,000 for Notification for Guidance, S\$40,000 for Notification for Decision.

When it may be appropriate to consider a notification under the streamlined process

20. To reach a decision on whether CCS uses the streamlined process, a number of factors will be considered to assess if the process will be appropriate. The factors are only indicative and are designed to be pragmatic and flexible, rather than prescriptive. While not all requirements need to be fulfilled for the streamlined process to be available, the framework of requirements provided below is non-exhaustive.

21. For the streamlined process to be available, CCS will consider if some or all of the following factors have been met:

- (i) Lodging the application earlier was not a viable option, hence necessitating the request for urgent assessment⁵;
- (ii) If the agreement was assessed under CCS'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 CCS is feasible (e.g. for cases where competition assessment is not exceptionally complicated), facilitated by documents and information provided by the Parties; and
- (v) There is broad consensus of interested parties in favour of the agreement

Stopping the clock

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

23. In this regard, CCS may from time to time ask the airlines to provide additional information. CCS will require the airlines to furnish the additional information by such deadline as CCS considers appropriate. In situations where the airlines are unable to provide the necessary information within a tight timeframe, CCS consequently may not have sufficient time to perform its assessments. This necessitates a "clock-stoppage" mechanism as part of the streamlined process, thereby extending the indicative timeframe for the streamlined process. In both Phase 1 and Phase 2 of the streamlined process, CCS may also consider commitments proposed by the airlines as a suitable remedy for the identified competition concerns. In such cases where there is a need to accommodate the commitments procedure including the need to consult with third parties on the proposed commitments, it may also be necessary for CCS to "stop the clock".

⁵ 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.

Review of the streamlined process

24. When using the streamlined process, CCS will keep under review whether the process remains appropriate. Should CCS decide that the streamlined process is no longer appropriate, such as when issues become more complex than they initially appeared to, the parties to the notification will be informed of the reasons for this decision. The airlines may then respond to the concerns, and may provide new evidence for CCS to consider if it is still appropriate to consider the notification under the streamlined process. Similarly, during the standard ND/NG process, CCS may deem it appropriate to consider the application under the streamlined process and will inform the airlines if this is the case.

25. If CCS concludes that it is no longer appropriate to consider a notification under the streamlined process, the airlines would have the option of allowing CCS to consider the notification outside of the streamlined process.

SUBSTANTIVE MATTERS

Route-by-route approach to market definition

CCS's Approach

26. CCS 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.

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

28. CCS 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 CCS 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.

29. In this regard, the CCS Guidelines on the Section 34 Prohibition provides for CCS 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

30. 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, CCS will consider if OD routes, 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. 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.

Information required

31. 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 CCS’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

32. In some of CCS’s previous notifications, airlines had submitted that differentiated products (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.

CCS’s Approach

33. CCS considers if differentiated products 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 CCS will consider these one-stop flights to be within the relevant market. Similar approaches have been considered by competition authorities overseas. Currently, CCS first defines the relevant market before conducting a market share analysis to assess whether the differentiated products compete within the same relevant market.

34. 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.

35. 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.

36. CCS will continue to use market shares as an important starting point for the assessment of differentiated products. Information helpful for CCS 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).

37. In addition to market share analysis, CCS 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

38. Price correlation measures the extent to which prices of two products move in tandem over time.⁶ 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

39. Information helpful for CCS'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

⁶ 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.

(e.g. fuel cost fluctuations etc.) will also be helpful to avoid spurious correlation between prices of different products.

Diversion ratio analysis

40. 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.

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

41. 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.⁷

Information required

42. Information that will be helpful for CCS'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

43. 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.⁸

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

⁷ For more complicated cases, the CCS 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.

⁸ 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.

44. 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.⁹

Information required

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

The Counterfactual

46. 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.

CCS's Approach

47. 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. CCS 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.

48. CCS will consider all available evidence to decide on the relevant counterfactual. In particular, information that will be useful for CCS'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.

49. One counterfactual that CCS 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, CCS 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.

⁹ 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.

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).

50. 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:

- i. First, upon applying appropriate cost allocation rules, the OD route would have a negative cash flow on an operating basis¹⁰;
- 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.

Metal Neutrality as Object Restriction

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

CCS’s Approach

52. Given that airline joint venture agreements often contemplate coordination between the parties on pricing, capacity, frequency and scheduling of flights, and where revenue is shared between the alliance airlines according to the capacity output by each airline, CCS assesses such “metal neutral” alliances as an “object” restriction when assessing the nature of the infringement. Paragraph 2.22 of the section 34 Guidelines states that:

“the words “object or effect” are alternative, and not cumulative, requirements. Once it has been established that an agreement has as its object the appreciable restriction of competition, CCS need not go further to demonstrate anti-competitive effects. On the other hand, if an agreement is not restrictive of competition by object, CCS will examine whether it has appreciable adverse effects on competition.”

53. The section 34 Guidelines also state that the assessment of whether or not an agreement has as its object the restriction of competition is based on a number of factors including the content of the agreement, the objective aim and the actual conduct of the parties. Agreements involving price-fixing would always be considered to be agreements with the object of restricting competition. Consequently, metal neutral

¹⁰ However, CCS might need to consider whether an unprofitable route might nonetheless be sustainable on a network basis, such as serving as a feeder route.

airlines alliances involving joint-pricing have always been found to have the object of restricting competition. This has been the approach consistently adopted across CCS's cases involving metal neutral airline alliances.

54. While the approach to assess airline alliance agreements, in particular metal neutral agreements under the "object" restriction is correct and in line with approaches in overseas jurisdictions, CCS will still conduct an effects test for the purpose of assessing the balance of harm and benefits under the Net Economic Benefit ("NEB") test. A sliding scale approach will be used to assess whether the benefits brought about by the agreement would be sufficient to outweigh the harm.

Information required

55. 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

56. CCS 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.

CCS's Approach

57. CCS 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.¹¹

58. CCS 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;

¹¹ To understand what constitutes likely, sufficient and timely entry, airlines may refer to the CCS Guidelines on the Substantive Assessment of Mergers.

- (ii) on whether they would enter the market if the incumbents were to raise their prices above competitive levels; and
- (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

59. 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.

CCS's Approach

60. 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.

61. 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

62. 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.

63. CCS has considered whether benefits accrued to these different categories of passengers should carry different weight. 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.

CCS's Approach

64. In the *SIA/Lufthansa* case, CCS 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, CCS accepted a commitment from the parties that Singapore-based passengers be no worse off, vis-à-vis other types of passengers.

65. CCS 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.