

## Gilbert Jewel

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**From:** JCallaghan@gtlaw.com.au  
**Sent:** Monday, 23 June 2003 9:49 AM  
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**Subject:** RJSA



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Dear Sir/Madam

We act for Virgin Blue.

Please find attached the submissions of Virgin Blue responding to the application of Qantas Airways Limited and its subsidiaries and British Airways PLC and its subsidiaries for authorisation to continue to give effect to the Restated Joint Services Agreement and any related and consequential coordination of schedules and pricing between the applicants.

If you have any questions please let us know.

Jonathan Callaghan/Luke Woodward

(See attached file: Docs\_632298\_1.PDF)

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**SUBMISSION TO AUSTRALIAN COMPETITION AND CONSUMER COMMISSION**

**APPLICATION FOR RE-AUTHORISATION OF THE RESTATED JOINT SERVICES AGREEMENT BY**

**QANTAS AIRWAYS LIMITED AND BRITISH AIRWAYS PLC**

**20 JUNE 2003**

On 6 May 2003, Qantas Airways Limited and its subsidiaries (**Qantas**) and British Airways PLC and its subsidiaries (**British Airways**) (collectively the **Applicants**) applied pursuant to sub-section 88(1) of the *Trade Practices Act 1974 (TPA)* for authorisation to continue to give effect to the Restated Joint Services Agreement (**JSA**) and any related and consequential coordination of schedules and pricing between the Applicants (**Application**). The Application was supported by a submission (**Submission**) and a report prepared by NECG (**NECG Report**).

This document contains the submissions of Virgin Blue to the Commission for the purpose of its assessment of the Application.

### **SUMMARY**

1. Virgin Blue believes that the analysis provided by the Applicants of the competitive detriments and the public benefits of the allowing the JSA to continue is inadequate.
2. The Applicants have failed to properly analyse the anti-competitive effects of the JSA in Australian domestic trunk and regional markets as they have not had regard to the extent to which Qantas takes advantage of its market power in markets for the provision of international air services between Australia and its position as the only provider of these services who also provides domestic trunk and regional services, in order to lessen the ability of its competitors in domestic trunk and regional air services markets to compete.
3. Qantas takes advantage of this position by offering discounts to customers where they acquire their regional, domestic trunk and international air services requirements from Qantas. That is, it bundles its offers for the various services. This conduct has the practical effect of making it commercially unfeasible for customers to purchase the domestic trunk and regional services of Qantas' competitors. By allowing the JSA to continue, the Commission significantly increases Qantas' ability to engage in this conduct, which significantly lessens the ability of airlines such as REX and Virgin Blue to compete with Qantas.
4. Further, the majority of the public benefits cited by the Applicants are either private benefits accruing to Qantas and British Airways to which less weight should be given by the Commission or would appear to be greatly overstated.
5. Accordingly, Virgin Blue does not believe that the Applicants have established a sound basis upon which the Commission could grant the authorisation requested.
6. If the Commission were minded to re-authorise the JSA it should only do so:

- (a) for a limited period of time; and
- (b) where Qantas provides court enforceable undertakings to the Commission that it will refrain from offering any discount or benefit to customers where they acquire their international, regional and domestic trunk air services requirements from Qantas.

## **VIRGIN BLUE**

- 7. The Virgin Group announced the commencement of a low-fare airline<sup>1</sup> in Australia in November 1999. Virgin Blue commenced operations on 31 August 2000.
- 8. When Virgin Blue commenced operations in August 2000, it serviced the Brisbane-Sydney and Brisbane-Melbourne routes with four Boeing 737s. At the time of Ansett's collapse it operated approximately nine Boeing 737s and flew approximately five routes. Virgin Blue now operates 29 Boeing 737s on a number of routes with 1330 departures per week.
- 9. Virgin Blue is currently actively seeking opportunities to fly to international destinations. It has sought expressions of interest from Airports within the Asia/Pacific region that wish to be included in the Virgin Blue network. While there are a number of international destinations under consideration, few of the international routes that Virgin Blue is currently considering are JSA routes.

## **RESPONSE TO CASE FOR AUTHORISATION**

### **Detriment**

- 10. The Applicants' analysis of the competitive detriment of the JSA has focused almost entirely on the competitive detriment that giving effect to the JSA would have on the JSA passenger and freight markets. Virgin Blue considers that such an analysis is incomplete as it does not properly identify or analyse the competitive detriments suffered in Australian domestic trunk and regional air services markets.
- 11. Any analysis of the competitive effect of the JSA on the domestic markets must have regard to the manner in which Qantas' dominance of international services between Australia increases the market power of Qantas in domestic trunk and regional air services markets in Australia.

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<sup>1</sup> The concept of a low fare airline is explained in more detail in the US Department of Transport's paper *The Low Cost Airline Service Revolution* dated 23 April 1996

12. Qantas is currently the only airline that provides international services between Australia as well as domestic trunk and regional services in Australia. Qantas takes advantage of this position by offering discounts to its customers where they purchase their international, domestic trunk and regional air services requirements from Qantas. Virgin Blue understands this global product offer is known as a gross financial offer or GFO.
13. It is Virgin Blue's understanding that a GFO operates in the following way. Take, for example, a overseas company that has operations in Albury/Wodonga. Such a company would need to purchase airfares for regional, domestic trunk and international services. Qantas is in a position to bundle together these three services in a way that creates an incentive for the company to use it for all its air travel requirements. For example, if Qantas provides a discount off the overall level of travel acquired, provided the customer meets a minimum level of travel spend, then the customer has an incentive to use Qantas to build up to the minimum level of travel. Virgin Blue understands that this is in fact what Qantas does. Virgin Blue understands that Qantas and the customer estimate the expected **total** airfare spend for that customer over a given period having regard to its anticipated travel needs. Qantas will then make a gross financial offer which is attractive to the customer on the basis that it spends an agreed amount with Qantas, which is typically slightly less than the total estimated spend. This means, in effect, that a customer will be reluctant to use any airline other than Qantas in order to receive the GFO discount.
14. Obviously, Qantas' competitors in domestic trunk and regional markets cannot offer such a bundled package of services. For this reason, the GFO significantly impacts upon the ability of domestic trunk and regional competitors such as Virgin Blue and REX to compete with Qantas. The JSA supports and maintains Qantas' ability to engage in this conduct by enhancing the quality of the GFO product. The appeal of the GFO is enhanced by the high frequency, low cost international air fares to perhaps the most significant business travel destinations from Australia, that Qantas can offer by virtue of the benefits flowing to it from the JSA. Certainly, the attractiveness of any bundled product offered by Qantas would be less if the JSA did not exist.

*Arguments of the Applicants*

15. The Applicants' analysis of the competitive effects of the JSA on domestic trunk and regional markets is inadequate for the reasons outlined above. In this section Virgin Blue addresses briefly the arguments advanced by the Applicants as to why the JSA has no effect on domestic trunk or regional markets.
16. The Applicants have dismissed there being any potential for the JSA to have any competitive detriment in Australian domestic markets. The reason given for this is that

there is a low incidence of passengers connecting directly from an overseas point onto a Qantas domestic flight at any Australian gateway, that is, international services provide little feed to domestic services and therefore the impact on the domestic market will be minimal. Further, and in any case, given the business model of value based airlines such as Virgin Blue, feeder traffic is not important to it and accordingly the JSA will have little impact upon it.<sup>2</sup> This analysis is incorrect in a number of regards.

17. The Applicants have clearly measured feeder traffic in a way designed to understate the importance of feeder traffic. The Applicants have only looked at “passengers connected from an overseas point onto a Qantas domestic flight”<sup>3</sup>. They have not taken into account the large number of international visitors that travel on domestic flights other than through a direct international connection. Most international visitors to Australia would not necessarily catch a directly connecting flight when they arrive in Australia but rather stop and visit that city. They then might, after a few days, travel to the next destination where they will stop for few more days before travelling on again. Each domestic trip will often be made on tickets purchased as a bundle along with the international tickets at the beginning of the journey.
18. If the Applicants were to measure the number of international passengers travelling on Qantas’ domestic services that purchased their ticket along with their international ticket from the Applicants (as a bundle), as well as those that directly connect from an international flight on to a Qantas domestic flight, it will demonstrate that feed from the JSA’s international services to Qantas’ domestic services is significant.
19. It is simply incorrect to say that VBA’s or a low cost airline do not value feeder traffic. A value based airline will not operate an unprofitable service simply to obtain feed from that service, however, it does value feeder traffic. It will arrange its schedules so as to maximise feed between its services and a VBA will enter into feeder arrangements with other airlines.
20. The Applicants have suggested that it is open to Virgin Blue to enter into code share arrangements with other JSA carriers. However, as the market share information provided by the Applicants demonstrates, the Applicants maintain between a 40-45% market share in most of the relevant markets. The remainder of the market share is typically divided between at least ten other airlines with an average market share of about 5%. It is not possible to enter into numerous minor code share arrangements with a diverse number of carriers as the arrangements will not be efficient due to difficulties in synchronising schedules. Given these market dynamics, the opportunity for Virgin Blue

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<sup>2</sup> at page 140 of the NECG Report

<sup>3</sup> at page 140 of the NECG Report.

to enter into a useful code share arrangement is limited as no one arrangement will provide a large amount of feeder traffic.

21. Both the Commission and the New Zealand Commerce Commission in their draft determinations on applications by Qantas and Air New Zealand to enter into certain co-operative arrangements (**Air NZ Alliance**) found that access to feeder services is a significant barrier to entry. Therefore, by maintaining arrangements that have the effect of lessening the ability of competitors of Qantas to enter into meaningful and productive feeder relationship must have the effect of increasing barriers to entry.

#### **Benefits**

22. The Applicants have identified a number of benefits. These can be summarised as:
- (a) cost savings;
  - (b) lower fares;
  - (c) an increase in net exports;
  - (d) additional employment;
  - (e) increased tourism;
  - (f) product and service benefits; and
  - (g) increased international competitiveness of Qantas
23. Virgin Blue does not accept that the JSA provides many of the benefits claimed by the Applicants:
- (a) for a number of reasons Virgin Blue does not accept that the JSA results in an increase in tourism to Australia. For example:
    - if the JSA routes are as competitive and barriers to entry are as low as the Applicants claim, Virgin Blue does not accept that there will be a reduction in capacity on the JSA routes should the JSA not continue;
    - Virgin Blue does not accept that there will be a reduction in the amount Qantas spends on promotional activity if the JSA were removed. It suspects that the removal of the JSA will cause an increase in promotional

activity by both British Airways and Qantas as the two largest suppliers of air services on the JSA routes will seek to consolidate their positions in the UK, Australia and in the Asian mid point destinations;

- if a decrease in promotional spending had the effect the Applicants claim, the Australian Tourist Commission would be expected to increase its promotional spending; and
  - these claims are very similar to those made by the Qantas and Air New Zealand in the context of the assessment of the Air NZ Alliance, which both the Commission and the New Zealand Commerce Commission found to be greatly overstated.
- (b) Virgin Blue does not accept that the JSA results in a higher quality products and services. If the JSA routes are as competitive as the Applicants claim, it is unlikely that there will be a reduction in capacity on the JSA routes or a decrease in the quality of those services; and
- (c) for the reasons outlined above Virgin Blue does not expect that the discontinuation of the JSA will result in a significant decrease in capacity on the JSA routes and accordingly the Applicants' claims of lower air fares are spurious.

#### **APPLICATION OF AUTHORISATION TEST**

24. The Applicants have sought authorisation of the Proposed Alliance pursuant to section 88(1) TPA on the grounds that the public benefits of the Proposed Alliance outweigh the public detriments.
25. In order to authorise the JSA, the Commission must be positively satisfied that giving effect to the JSA would result or be likely to result in a benefit to the public and that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result if the Alliance was given effect.<sup>4</sup>
26. The concept of a public benefit has been described as:

*anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements (in the context of*

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<sup>4</sup> See s 90(1) of the TPA.



*trade practices legislation) the achievement of the economic goals of efficiency and progress.*<sup>5</sup>

27. It is the Commission's task to weigh or balance public benefits and detriments, as contemplated in sub-section 88(1). However, this does not imply that the Commission must apply some quantitative assessment to each item. Nor does it determine what the Commission must weigh in the balance as a public benefit or a public detriment. For example, in Australia, there has been no acceptance that a quantitative total welfare analysis is required or even desirable. Furthermore, in Australia it is clear that greater weight is to be accorded benefits which flow through to the public generally. Similarly, if the gains accrue privately (even to shareholders in public companies) and the detriments impact upon the public generally the Commission should be cautious about granting authorisation.
28. Historically, in Australia, there has been an understandable reluctance to allow a private benefit to fully off-set a public detriment. In practice, such a model may not properly factor in the erosion of productive and dynamic efficiency that will flow from a lessening of competition.<sup>6</sup> This is also reflected in decisions of the Tribunal which indicate that less weight is to be given to benefits which do not flow through to consumers and the public generally.<sup>7</sup>
29. Importantly, the Applicant bears the onus of establishing its case.<sup>8</sup> This requires that the Applicant provide substantive and probative material which would establish its case.<sup>9</sup> Further, it requires that the Applicant establish a causal connection between the claimed benefits and the conduct.<sup>10</sup>
30. Virgin Blue does not believe that the Applicants have made their case for authorisation. The analysis provided by the Applications is inadequate as:
  - (a) the Applicants have failed to properly analyse the anti-competitive effects of the JSA in Australian domestic trunk markets and regional markets as they have not had regard to the extent to which Qantas takes advantage of its market power in markets for the provision of international air services between Australia and its

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<sup>5</sup> *Queensland Co-Op Milling Assn Ltd and Defiance Holdings Ltd (QCMA)* (1976) ATP 40-012 at 17,242.

<sup>6</sup> See the decisions of the Commission in *(Aust) Pty Ltd* (1996) ATPR (Com) ¶50-232; Decision of the Commission in *Australian Pharmaceutical Industries Limited* in respect of Proposed merger with *Sigma Company Limited* Date: 11 September 2002 Authorisation No:A30215.

<sup>7</sup> *Re Westralian Farmers Cooperative Ltd* (1979) ATPR 40 -110; *Re Howard Smith Industries Pty Ltd and Adelaide Steamship Industries Pty Ltd* (1977) ATPR 40-023 (**Howard Smith**).

<sup>8</sup> *QCMA* at 17,224 and *Re John Dee (Export) Pty Ltd* (1989) ATPR 40-938 at 50,206.

<sup>9</sup> See *Re Howard Smith*

<sup>10</sup> *Re 7-Eleven Stores Pty Ltd* (1994) ATPR 41-357 at 42,677.

position as the only provider of these services who also provides domestic trunk and regional services, in order to lessen the ability of its competitors in domestic trunk and regional air services market to compete. The bundling conduct of Qantas in its GFO has the practical effect of preventing its customers from purchasing the domestic trunk and regional services of Qantas' competitors. By allowing the JSA to continue, the Commission significantly increases Qantas' ability to engage in this conduct, which significantly lessens the ability of airlines such as REX and Virgin Blue to compete with Qantas; and

- (b) the majority of the public benefits cited are either private benefits accruing Qantas and British Airways alone or would appear to be greatly overstated.