General Counsel
Brett Johnson

5 September 2003

Mr Scott Gregson
Director
Adjudication Branch
Australian Competition and Consumer Commission
470 Northbourne Avenue
DICKSON ACT 2602

Dear Mr Gregson

Qantas Airways Limited and British Airways PLC
<u>Applications for Reauthorisation of Restated Joint Services Agreement (JSA)</u>

I refer to your letter of 30 June 2003 and my response of 7 August 2003.

Attached are:

1. answer to Question 4 from the Commission's letter of 30 June 2003 (Attachment 1); and
2. additional information on the shared facilities related IT cost savings attributed to the JSA (Attachment 2).

Attachments 1 and 2 to this letter include certain commercially confidential information. Disclosure of that information could result in material financial loss and prejudice the competitive position of the Applicants. Pursuant to section 89(5) of the Trade Practices Act, the Applicants apply for this information to be kept confidential by the Commission and excluded from the register kept by the Commission in accordance with section 89(3) of the Act. For convenience, the confidential information is indicated by the use of bold red square parentheses around confidential text or around the heading of a confidential table or graph.

Yours sincerely

Brett Johnson
General Counsel

cc Roger Featherston
Mallesons Stephen Jaques

<u>**Attachment 1**</u>

Q4 ***An outline of the movements in price in first class and business class fares between May 1995 and the present on JSA Routes and the comparison of these fares with those offered by other carriers.***

Both Qantas and British Airways offer a range of published and net fares in each of business and first class. In addition, the Applicants negotiate a range of special fares for businesses with high volumes of travel on JSA Routes (often referred to as "private fares"). As a result, it is difficult, and likely to be misleading, to provide an outline of movements in published fares in these cabins. Because of this difficulty, general airline practice is to look at the overall yield achieved in each cabin, measured in cents of revenue earned per kilometre, per passenger carried (c/RPK). This measure allows comparisons of the average amount paid by passengers in each cabin to be made over time.

The confidential graphs set out below show a moving average of the Applicants' yields in the business and first class cabins over time. The upper line shows the unadjusted average yield in each cabin across all of the Applicants' JSA Services. The lower line shows those yields adjusted for changes in CPI to show price movements in real terms.

[<u>**Confidential Information Deleted**</u>]

The graphs shows that, in real terms, the average price of travel in the Applicants' first and business class cabins has declined substantially in recent years. At the same time, product standards have increased significantly. For example, British Airways and Qantas have both introduced fully reclining beds in first class in place of conventional seats. These beds require significantly more space than conventional seating and therefore cost much more per passenger to provide than conventional seats. British Airways also introduced beds in business class in 2001, which increased the average space required per passenger in that cabin by over [<u>**Confidential Information Deleted**</u>]. Other improvements in product standards are described in paragraphs 5.28 to 5.34 of the Submission that accompanied the Applicants' application for authorisation.

It is relevant to note also that a significant proportion of fares in premium class cabins are purchased by businesses that have negotiated volume rebates with the Applicants. The net price paid by such businesses for tickets is equal to the amount paid on purchase, less any rebates paid at the end of a particular travel period. The yield graphs shown above do not take these rebates into account.

The Applicants do not have information on the yields of other carriers on the JSA Routes.

Attachment 2

Additional Information on IT Cost Savings Related to Shared Facilities

The JSA has facilitated Qantas and British Airways sharing offices and IT infrastructure in a number of locations worldwide. Without the JSA these combined operations in key locations (such as Singapore and Thailand) are likely to cease and a number of changes would need to be made in other locations. This would result in both parties incurring additional costs if the JSA were not reauthorised.

Table 53 of the NECG report sets out the 16 countries in which British Airways and Qantas operate joint facilities. Table 54 sets out the additional facilities costs, excluding IT costs, associated with the loss of the JSA. In Section 1.1.1 of the NECG Report, the additional IT facilities costs associated with the loss of the JSA are estimated at A$**[Confidential Information Deleted]** each per annum for both British Airways and Qantas. These additional IT facilities costs associated with the loss of the JSA are of three major types:

- Voice and Data Network Services – absent the JSA, Qantas would need to increase its use of a range of services including telephone circuits, PABXs, routers, communication processors and international circuits. This is because Qantas would need to provide IT facilities to an increased number of staff (as described elsewhere, these extra staff would be required to fulfil functions carried out under the JSA by BA staff) at an increased number of individual facilities (this is because Qantas and British Airways would need to separate their operations at a number of locations, requiring duplication of a range of IT facilities).

- Central Help – currently British Airways' and Qantas' IT support teams combine to provide 24 hour IT support. Absent the JSA, Qantas would need extra staff in the IT Support Centre to handle non-Australian business hour enquiries that are currently dealt with by British Airways teams.

- Regional IT staff – Qantas' overseas operations in many parts of the world currently rely on IT resources provided by British Airways. Without British Airways' contribution, Qantas would need to increase expenditure on local IT consultants to provide local knowledge, management support and supplier liaison.

Voice and data network services are likely to make up the largest component of the additional costs. Assuming that the JSA is reauthorised, Qantas expects to spend approximately A$**[Confidential Information Deleted]** in total for voice and data network services in 2004/05. Of this, A$**[Confidential Information Deleted]** is expected to be spent in overseas regions. Qantas conservatively estimates that a 10% increase in overseas voice and data network capacity would be required in the absence of the JSA. Thus, Qantas' costs would increase by approximately A$**[Confidential Information Deleted]** in 2004/2005.

Qantas currently has 15 FTE staff in the Central Help Unit and estimates that it would need an extra 5 FTE staff to adequately cover the expected increases in after Australian business hours support calls absent the JSA. At an estimated cost of $**[Confidential Information Deleted]** per year per FTE[1] this would result in a total additional annual cost of $**[Confidential Information Deleted]**.

In 2001/2002 Qantas spent approximately A$**[Confidential Information Deleted]** on IT consultants in overseas regions. Qantas estimates that the loss of the JSA would increase these costs by approximately 10% amounting to an additional cost of A$**[Confidential Information Deleted]** per year.

The table below sets out a break down of the estimated additional annual costs which would be incurred absent the JSA. It is assumed that these costs are constant over the 5-year period in which the JSA benefits are estimated.

[Confidential Information Deleted]

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1 This cost estimate includes wages and other employment costs such as provision of equipment.