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Public Register Version

Meeting with Virgin Atlantic

10.00 am, 29 September 2003, Le Meridien Hotel, Russell Square, London

Virgin Atlantic:
Vanessa Tamms, Manager, Competition and Regulatory Affairs
Jill Brady, General Manager, Legal
Chris Humphrey, Manager, Government and External Affairs

ACCC:
Tim Grimwade, General Manager, Adjudication
Greg Outzen, Consultant

Tim Grimwade (TG) provided a general background to the authorisation process and indicated a report of the meeting would be placed on the Commission's Public Register.

Vanessa Tamms (VT) advised that Virgin (Virgin Atlantic) had sought a meeting to expand on the Virgin submission in response to the application for the re-authorisation of the Qantas/British Airways Joint Services Agreement (JSA).

Greg Outzen (GO) asked if Virgin had seen the Qantas/BA response to the Virgin submission. Virgin had not and ACCC indicated a copy would be forwarded.

VT stated that Virgin was concerned not just at the impact of the JSA on routes directly involved but also the ability it gave to the Applicants to leverage outcomes on other routes.

Virgin is keen to fly to Australia providing barriers in the form of beyond rights over Hong Kong can be overcome and the ACCC re-establishes a level playing field in the relevant markets by remedying competition concerns.

[*Confidential*.] BA may also bid for those rights

- If there are only limited beyond rights, capacity is allocated through "scarce capacity" hearings conducted by the UK Civil Aviation Authority. Preference is given in such circumstances to new entrants so as to increase competition. Decisions are appealable to the Secretary of State for Transport.

- Code share rights are also likely to emerge from the bilateral negotiations. Talks were scheduled to occur shortly. Cathay Pacific was looking for trans-Atlantic rights as part of the deal.

GO asked what Virgin would bring to the JSA route and how it would increase competition. VT advised that Virgin operates three classes – business (with beds), premium economy and economy. Virgin was a very innovative operator, would compete vigorously on price and product and was a proven successful competitor. Examples were the provision of limousine services for business class passengers, a newly configured business class, an on-board bar, and separate departing and arriving lounges (the latter enabling travellers to freshen up before proceeding directly to meetings). Virgin was also the first airline to provide seat back entertainment systems for economy class passengers. BA produced its World Traveller Plus class in response to Virgin's premium economy class initiatives.

Virgin anticipates entering Australian markets in the next 12 months. It is committed to the acquisition of 10 A340-600 aircraft (5 of which have been delivered and are in service) and 6 A380 aircraft (and options for a further 6). Virgin currently operates daily flights to Hong Kong from Heathrow. It will need three aircraft to operate daily services from Heathrow to Australia over Hong Kong compared to the two used to provide daily services to Hong Kong.

TG asked if there were advantages operating out of Heathrow compared to Gatwick. Virgin considered there were advantages in operating from Heathrow which were true for both long haul and short haul travel, the main benefit being higher yields. Virgin added it operated out of Gatwick simply because there were no other slots available at Heathrow. Heathrow held advantages over Gatwick in that it offered good transport links (which was important for time-sensitive travellers), connectivity and critical mass. Heathrow competes with Gatwick but Gatwick does not compete with Heathrow. All flights to Australia via Hong Kong would originate from Heathrow.

Virgin stated that it believed that the ACCC defined the relevant geographic markets incorrectly. It believed that the relevant geographic markets are city pair markets (i.e. London – Sydney is a different market from London – Melbourne) and that special consideration needs to be given to Heathrow airport. This means that the ACCC's analysis of the costs and benefits, if any, associated with the RJSA and its predecessor were conducted relative to the wrong markets. The ACCC would therefore need to examine the impacts of the RJSA on each city pair market.

TG asked how Virgin's travel sales were distributed. Virgin advises it used all facilities, ie web sales, call centres and travel agents. [*Confidential.*]

GO asked the extent of Virgin's alignment with other airlines. Virgin responded that it is generally non-aligned, commenting that alliances tend to operate only at the level of the lowest common denominator of the airlines involved. It is prepared to look at code share arrangements where there are clear benefits flowing. Virgin is sceptical of cost savings arguments raised by airlines in support of alliances. Its experience, as evidenced by studies, is that in the airline industry unit costs do not decrease as airline size increases. Virgin does not believe that BA would withdraw services to Australia, as claimed, if the JSA was not re-authorised. This is because BA withdrew services to Perth and Brisbane (in July 2000 and November 2000 respectively) after the RJSA was authorised (in May 2000).

TG noted that Virgin had submitted that any re-authorisation of the JSA should be conditional on Qantas and BA giving up slots, including at Heathrow. What guarantee would Virgin have of acquiring surrendered slots? Virgin replied that the European Commission, to remedy competition concerns, frequently requires applicants to surrender slots to an airline for use in the markets where the concerns arise. Virgin would not necessarily get the slots. However the acquisition of the slots by any other airline for use in the relevant markets would also go some way towards remedying the effect on competition in these markets of the RJSA.

[*Confidential.*] Virgin advised that there was limited scope for third party action in the UK.

GO noted that Virgin had submitted that there is a separate market for time sensitive or business travellers and that Qantas/BA had an unfair advantage in that market. GO asked why other airlines had difficulty competing for business travellers. Virgin responded that Qantas and BA provide by far the greatest flight frequency in the relevant markets (which competitors cannot match due to the slot situation at Heathrow) and structure their corporate deals, frequent flyer programmes and travel agency commission schemes in such a way as to exclude competitors from markets in which they face effective competition. The JSA strengthened the power of Qantas and BA in all these areas to the detriment of other airlines. Reduced ability to compete for business travellers produced lower yields and a limited ability to compete generally.

Virgin noted that in its determination dated 10 May 2000, the ACCC was unable to conclude that market outcomes favourable to consumers in the relevant markets subsequent to the ACCC's approval of the JSA in 1995 could be attributable to the JSA. Rather it stated that these could be the outcome of the entry of airlines such as Singapore Airlines and Malaysian Airlines and the East Asian financial crisis. Virgin stated that in order to re-authorise the RJSA, therefore, the ACCC would need to establish that there are substantial benefits arising from the RJSA. Virgin said it has also noted the ACCC's conclusion with respect to public benefits arising from cooperation in the case of Qantas/Air New Zealand.