



14 November 2003

Strictly Confidential

Ms Isabelle Arnaud
Director – Adjudication Branch
Australian Competition and Consumer Commission
470 Northbourne Avenue
DICKSON ACT 2602

Dear Ms Arnaud

**Qantas Airways Limited and British Airways PLC
Application for Reauthorisation of Restated Joint Services Agreement (JSA) (A30226 and
A30227)**

We refer to our letter of 13 October 2003 in which we provided responses to a number of questions asked by the Commission in its letter of 25 September 2003. NECG has now prepared responses to questions 5 and 6 from the Commission's letter and has prepared revised modelling in response to question 7. These responses and revised modelling are set out in Attachment 1. We set out responses to the remaining questions from your letter below. We have responded to the Commission's letter of 31 October 2003 in our response to question 13 below.

As with our other responses to the Commission, these responses include 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. This information has been deleted and replaced with "[CONFIDENTIAL INFORMATION DELETED]" in the non-confidential public version of this letter. All attachments other than Attachments 2 and 3 to this letter are confidential.

Q9 *Tables 42, 43 and 44 of the NECG Report provide details of scheduled services currently operated by Qantas and BA and proposed to be operated under the JSA in the medium and long term respectively from Australia to Singapore, Bangkok and London.*

- (i) For each airline and for each city pair, please advise the total number of seats operated per week in each seating class for the schedules presented in each of the three tables. A presentation along the lines of Attachment 1 to Qantas' letter to the Commission of 3 February 2000 in respect of the Commission's previous consideration of the JSA would be appropriate.***
- (ii) Please advise the Commission of any changes that have occurred in the Qantas and BA schedules from those advised to the Commission by Qantas in its letter of 3 February 2000 as operable from November 2000.***

The letter from Qantas to the Commission dated 3 February 2000 was replaced by a letter to the Commission dated 25 February 2000. We have therefore treated all references to the letter of 3 February 2000 as references to the letter of 25 February 2000.

Attachment 2 sets out the total number of seats per week in each seating class represented by the schedules set out in Tables 42, 43 and 44 of the NECG Report.

The only changes between the intended November 2000 schedule advised to the Commission in Qantas' letter of 25 February 2000 and the schedule actually implemented by British Airways and Qantas from November 2000 were as follows:

- four services per week were operated by Qantas to Rome instead of three per week; and
- three services per week were operated by Qantas from Adelaide to Singapore instead of four per week.

Attachment 3 sets out a comparison between the schedule implemented from November 2000 and the current schedule.

Q11 *At page ii of the Qantas/BA Executive Summary it is stated that it is difficult to operate profitably to Europe because "...over half of Qantas' passengers disembark at the midpoint."*

- In terms of schedules presented in Table 42 of the NCG Report, please advise the number of seats Qantas operates to Singapore each week and how many it operates through Singapore to Europe.*
- For the latest year for which information is available, please advise the percentage of passengers on Qantas flights who arrived at Singapore:*
 - from Europe and had a destination other than Australia/New Zealand; and*
 - from Australia and had a destination other than Europe.*
- Please advise whether the passengers described as disembarking also include stopover passengers in transit.*

The schedule shown in Table 42 of the NCG Report represents the following number of seats to and via Singapore:

Seats per week to Singapore on flights continuing to Europe:	11,132
Seats per week to Singapore on flights terminating in Singapore:	<u>6,592</u>
Total seats per week to Singapore:	<u>17,724</u>

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In calculating these percentages, passengers who disembark in Singapore but who hold onward tickets with Qantas to Europe or Australia have been counted as through passengers, not terminating passengers.

Q13 *On page 2 of a letter dated 18 January 2000, Qantas supplied to the Commission details of the breakdown of total revenue by cabin for each of Qantas and BA on UK flights.*

- Please provide a breakdown of total revenue by cabin for each of Qantas and BA on UK flights in respect of all years subsequent to 1998/99.*
- Please advise the Commission of the expected change in the balance of revenue between the cabins after the introduction of Skybeds in business class on the Kangaroo route.*

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Q14 *In its determination A30202 of 10 May 2000 in relation to JSA the Commission stated that:*

" While the Commission is not asking Qantas and BA to supply it with information on fares and seats sold, it would expect them to be able to supply, if asked, information on the Europe and South East Asia markets in relation to:

- *the average revenue received per passenger per month for each cabin class; and*
- *the average number of discount economy seats sold per month and the proportion such seats constituted of all economy class seats (excluding World Traveller Plus or equivalent seats)."*

The Commission would be grateful if Qantas and BA would supply such information for each month in the period July 2000 to June 2003.

The average revenue per passenger received by Qantas in each month between July 2000 and June 2003 for JSA services between Australia and Asia and between Australia and Europe is set out in Attachment 4. The corresponding British Airways data is set out in Attachment 5.

To answer the question relating to the proportion of economy seats sold by Qantas and British Airways which are 'discount' seats, it is necessary to define a 'discount' seat.

The Commission will be aware that IATA publishes fares for travel between Australia and Europe. The unrestricted IATA published fare for economy class travel between Australia and Europe is currently \$9,090 return. Such a fare is often referred to as a 'full economy' fare and is booked in the 'Y' reservation class in the Qantas and British Airways yield management system.

Any fare sold for less than the 'full economy' price might fairly be described as a 'discount' fare.

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IATA also publishes 'excursion' fares for travel between Australia and Europe. The IATA excursion fare is substantially discounted from the full economy fare because it carries a number of conditions, including that the ticket is only available for use where there will be at least 10 days between the date of departure and the passenger's return date. The current IATA excursion fare for economy class travel between Australia and Europe is \$3,896 return for high season travel and \$3,044 for low season travel. These IATA excursion fares are booked in the 'H' reservation class in the Qantas and British Airways yield management system.

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In addition to IATA published fares, Qantas and British Airways publish their own fares which allow for flexible travel on JSA Routes. These fares may be regarded as discount fares in that they are set at competitive market levels and are significantly lower than relevant IATA published fares. These discount fares are highly flexible and available at all times during the year. These fares are booked in the 'H' and 'M' reservation classes in the Qantas and British Airways yield management system.

The current Qantas and British Airways 'H' class return fare between Australia and Europe is \$2,249 in low season and \$2,999 in high season. The current Qantas and British Airways 'M' class return fare between Australia and Europe is \$2,399 in low season and \$3,229 in high season. Neither fare carries any advance purchase requirements or minimum period away requirements and both allow unlimited itinerary changes without charge. The 'H' class fare allows travel to 25 destinations in Europe using British Airways' short haul network and carries a

\$330 fee for 'no show'¹. The M class fare allows travel to an even wider range of cities and allows 'no shows' without charge. Both fares will normally be available for sale up until the departure of a flight or very shortly prior.

Attachment 6 sets out the number of seats sold by Qantas on JSA Routes booked in reservation classes in the Qantas and British Airways yield management system other than 'Y', 'H' and 'M' for each month between July 2000 and June 2002. The seats sold in these reservation classes are all sold for less than the fare types described above.

It is important to note that even the 'Y', 'H' and 'M' reservation classes in the Qantas and British Airways yield management system include a significant proportion of seats that would commonly be described as 'discount'. These include the following:

- The 'M' reservation class includes 'round the world' tickets sold by Qantas and British Airways. These are very aggressively priced, low yielding fares. During the last six months of 2002 these low yield tickets booked in 'M' class accounted for approximately 7% of the economy class cabin.
- Seats purchased by businesses that have negotiated corporate discounts or rebates with Qantas would be regarded by most consumers as 'discounted' seats. Such seats, however, will commonly still be booked into the 'H' and 'M' reservation classes. Further information in relation to the proportion of seats sold in the economy cabin of JSA Services to which corporate discounts or rebates apply is provided in the answer to question 18.
- When travel demand is high and availability of seats in lower yielding fares classes is limited, it is not uncommon for travel agents to breach airline fare rules and book passengers who are only paying a highly discounted fare amount into 'Y', 'H' or 'M' reservation classes. This practice can distort the figures shown in Attachment 6.

The data in Attachment 6 may suggest a small reduction in the proportion of economy class seats accounted for by 'discount' seats in the first half of 2003. It is likely that this is associated with the reduction in leisure travel and the associated reduction of capacity by Qantas during the period of the Iraq conflict and the outbreak of SARS in Asia.

On any measure, however, it is clear that a very high proportion of seats on JSA Routes continue to be sold on a highly discounted basis. This reflects the continuing high levels of competition on JSA Routes. The continuing high level of competition on these routes is also reflected in fact that average revenues per passenger received by Qantas and British Airways in their economy cabins on these routes, as set out in Attachments 4 and 5, are far less than the 'H' and 'M' class fares described above.

Q15 *On page 1 of its letter to the Commission dated 18 January 2000, Qantas provided details of yields by cabin for fares sold from Australia to London, Frankfurt, Rome and Paris. Please provide details of yields by cabin for fares sold from Australia to London, Frankfurt, Rome and Paris for the years, 2000, 2001, and 2002.*

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Note: this table is confidential.

¹ A 'no show' is where a passenger fails to check in for travel on a flight that has been booked and instead travels on another flight or obtains a refund on their ticket. Such passengers create significant cost for airlines because by the time the passenger does not 'show', it is too late to resell that seat.

Q16 Please provide the Commission with seats factors and yield by cabin for Qantas and BA comparable with the answer provided to Question 2 in Qantas' letter of 18 January 2000.

Please see Attachment 7.

Q17 Please provide a break down of Qantas and BA fares sold in each cabin by whether they were published fares or net fares for the year ended 31 December 2002.

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Note: this table is confidential.

Q18 Please advise the Commission of the percentage of fares sold in each cabin for each of published and net fares [that] are private fares as described in the answer to Question 4 in Qantas' letter to the Commission of 5 September 2003.

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² Net fares are defined as fares where the amount required to be remitted to the airline by the selling agent is fixed irrespective of the selling price, rather than being determined as a proportion of a published recommended selling price.

We trust that these responses are of assistance. We recognise that the Commission may have further queries arising out of the data in these responses and are happy to answer any further questions.

In addition, we believe it is important to meet with the Commission in the near future to discuss any residual questions or concerns the Commission may have. We will contact your office to arrange a meeting.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brett Johnson', with a long horizontal flourish extending to the right.

Brett Johnson
General Counsel

cc Roger Featherston
Malesons Stephen Jaques

Attachment 2
Capacity measured in seats per week represented by NECG Tables 42, 43 and 44

Northern Summer 2003 Schedule (Table 42 NECG Report)								
QF Operated								
<u>City</u>	<u>Route</u>	<u>Aircraft</u>	<u>Freq</u>	<u>P</u>	<u>J</u>	<u>W</u>	<u>Y</u>	<u>Total</u>
SYD	SYD-SIN-LHR	747-400	7	98	455		2,205	2,758
	SYD-SIN-FRA	747-400	7		462		2,562	3,024
	SYD-BKK-LHR	747-400	7	98	455		2,205	2,758
	SYD-SIN-(MEL)	767-300	4		50		408	458
	Total Sydney			196	1,422		7,380	8,998
MEL	MEL-SIN-LHR	747-400	7	98	455		2,205	2,758
	(SYD)-SIN-MEL	767-300	4		50		408	458
	Total Melbourne			98	505		2,613	3,216
BNE	BNE-SIN	747-300	7		364		2,590	2,954
	Total Brisbane				364		2,590	2,954
PER	PER-SIN	767-300	7		175		1,428	1,603
	PER-SIN	747-400	1		66		366	432
	PER-SIN-FCO	747-400	3		198		1,098	1,296
	PER-SIN-CDG	747-400	3		198		1,098	1,296
	Total Perth				637		3,990	4,627
ADL/DRW	ADL-DRW-SIN	767-300	3		75		612	687
	Total Adelaide / Darwin				75		612	687
Total QF				294	3,003		17,185	20,482
BA Operated								
SYD	LHR-SIN-SYD	747-400	7	98	490	210	1,239	2,037
	LHR-BKK-SYD	747-400	7	98	266	252	1,841	2,457
	Total Sydney			196	756	462	3,080	4,494
MEL	LHR-SIN-MEL	747-400	7	98	266	252	1,841	2,457
	Total Melbourne			98	266	252	1,841	2,457
Total BA				294	1,022	714	4,921	6,951
Total JSA				588	4,025	714	22,106	27,433

Factual Short - Medium Term (Table 43 NECG Report)

QF Operated

<u>City</u>	<u>Route</u>	<u>Aircraft</u>	<u>Freq</u>	<u>P</u>	<u>J</u>	<u>W</u>	<u>Y</u>	<u>Total</u>
SYD	SYD-SIN-LHR	747-400	7	98	350		2,205	2,653
	SYD-SIN-FRA	747-400	7		462		2,562	3,024
	SYD-SIN-MEL	767-300	7		175		1,428	1,603
	SYD-BKK-LHR	747-400	7	98	350		2,205	2,653
	Total Sydney			196	1,337		8,400	9,933
MEL	MEL-SIN-LHR	747-400	7	98	350		2,205	2,653
	Total Melbourne			98	350		2,205	2,653
BNE	BNE-SIN	747-300	7		350		2,800	3,150
	Total Brisbane				350		2,800	3,150
PER	PER-SIN	767-300	7		175		1,428	1,603
	PER-SIN-FCO	747-400	3		198		1,098	1,296
	PER-SIN-CDG	747-400	5		330		1,830	2,160
	Total Perth				703		4,356	5,059
ADL/DRW	ADL-DRW-SIN	767-300	3		75		612	687
	Total Adelaide / Darwin				75		612	687

Total QF			294	2,815			18,373	21,482
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BA Operated

SYD	LHR-SIN-SYD	747-400	7	98	490	210	1,239	2,037
	LHR-BKK-SYD	747-400	7	98	266	252	1,841	2,457
	Total Sydney			196	756	462	3,080	4,494
MEL	LHR-SIN-MEL	747-400	7	98	266	252	1,841	2,457
	Total Melbourne			98	266	252	1,841	2,457

Total BA			294	1,022	714	4,921	6,951
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Total JSA			588	3,837	714	23,294	28,433
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Factual Long Term (Table 44 NECG Report)

QF Operated

<u>City</u>	<u>Route</u>	<u>Aircraft</u>	<u>Freq</u>	<u>P</u>	<u>J</u>	<u>W</u>	<u>Y</u>	<u>Total</u>
SYD	SYD-SIN-LHR	747-400	7	98	350		2,205	2,653
	SYD-SIN-FRA	747-400	7		462		2,562	3,024
	SYD-SIN-MEL	A330	7		210		1,869	2,079
	SYD-BKK-LHR	A380	7	98	546		2,898	3,542
	Total Sydney			196	1,568		9,534	11,298
MEL	MEL-SIN-LHR	A380	7	98	546		2,898	3,542
	Total Melbourne			98	546		2,898	3,542
BNE	BNE-SIN	747-300	7		350		2,800	3,150
	Total Brisbane				350		2,800	3,150
PER	PER-SIN	A330	7		210		1,869	2,079
	PER-SIN-FCO	747-400	3		198		1,098	1,296
	PER-SIN-CDG	747-400	7		462		2,562	3,024
	Total Perth				870		5,529	6,399
ADL/DRW	ADL-DRW-SIN	767-300	7		175		1,428	1,603
	Total Adelaide / Darwin				175		1,428	1,603

Total QF			294	3,509		22,189	25,992
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BA Operated

SYD	LHR-SIN-SYD	747-400	7	98	490	210	1,239	2,037
	LHR-BKK-SYD	747-400	7	98	266	252	1,841	2,457
	Total Sydney			196	756	462	3,080	4,494
MEL	LHR-SIN-MEL	747-400	7	98	266	252	1,841	2,457
	Total Melbourne			98	266	252	1,841	2,457

Total BA			294	1,022	714	4,921	6,951
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Total JSA			588	4,531	714	27,110	32,943
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Attachment 3
Comparison between November 2000 JSA schedule and current JSA schedule

Schedule implemented from November 2000				Winter 2003/2004				
<u>QF Operated</u>				<u>QF Operated</u>				
<u>City</u>	<u>Route</u>	<u>Aircraft</u>	<u>Freq</u>	<u>City</u>	<u>Route</u>	<u>Aircraft</u>	<u>Freq</u>	
SYD	SYD-BKK-LHR	747-400	7	SYD	SYD-BKK-LHR	747-400	7	
	SYD-SIN-FRA	747-400	4		SYD-SIN-LHR	747-400	7	
	SYD-SIN-CDG	747-400	3		SYD-SIN-FRA	747-400	7	
	SYD-SIN-BOM	767-300	7					
MEL	MEL-SIN-LHR	747-400	7	MEL	MEL-SIN-LHR	747-400	7	
	MEL-SIN-LHR	747-400	3					
	MEL-BKK-FRA	747-300	3					
	MEL-BKK-FCO	747-300	4					
BNE	BNE-SIN	767-300	11	BNE	BNE-SIN	747-400	7	
PER	PER-SIN	767-300	11	PER	PER-SIN	767-300	10	
	PER-SIN(-HKG)	767-300	7		PER-SIN-CDG	747-400	3	
					PER-SIN	747-400	1	
ADL	ADL-SIN	767-300	3	ADL	ADL-DRW-SIN	767-300	3	
CNS/DRW	CNS-DRW-SIN	767-300	7	CNS/DRW				
<u>BA Operated</u>				<u>BA Operated</u>				
<u>City</u>	<u>Route</u>	<u>Aircraft</u>	<u>Freq</u>	<u>City</u>	<u>Route</u>	<u>Aircraft</u>	<u>Freq</u>	
SYD	LHR-BKK-SYD	747-400	7	SYD	LHR-BKK-SYD	747-400	7	
	LHR-SIN-SYD	747-400	7		LHR-SIN-SYD	747-400	7	
MEL				MEL	LHR-SIN-MEL	747-400	7	

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[Confidential Attachment 5]

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[Confidential Attachment 6]

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[Confidential Attachment 7]

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Attachment 1

JSA: Response to the ACCC's information request 25/9/03

This note sets out NECG's answers to questions 5, 6 and 7 contained in Isabelle Arnaud's letter to Brett Johnson of Qantas Airways dated 25 September 2003.

Question 5

Please clarify whether the Monash Model multipliers were calculated with the assumption that a proportion of Qantas' variable costs are realised outside Australia. Please also outline the case specific inputs that guide the modelling of net economic surpluses emanating from Qantas' declining export sales revenue and tourist expenditure levels on JSA routes.

The MONASH model multipliers were calculated using a standard application of the MONASH model. As such, the multipliers derived from the model reflect the information contained in the database that underlies the model. As this database assumes that a significant proportion of the Air Transport Industries' costs are sourced overseas, the multipliers implicitly incorporate this feature as well.

In the 1998 MONASH database, the Air Transport Industry had \$10,795 million in costs of which \$6,005 million were domestically produced intermediate inputs and \$1,210 million were imported intermediate inputs. The main imported intermediate inputs were fuel with a value of \$651 million, and transport services (e.g. servicing of planes in foreign countries) with a value of \$276 million.

Question 6

Please advise whether the modelling conducted by NECG considered the effects of a proportion of Qantas' profits flowing to foreign investors. (The Commission understands that currently approximately 50 per cent of Qantas' shareholders are foreign investors.) Please advise the percentage of foreign equity holdings that the Monash Model generally implies. If the Monash Model did not consider the effect of 50 per cent of Qantas' profits flowing outside of Australia, please outline the impact that such a consideration would have on the modelling conducted by NECG.

The Centre of Policy Studies has advised that foreigners are assumed to own 14.4 per cent of the capital stock in the air transport sector in the MONASH model database for 1998. ABS data indicates that, in the Air Transport Industry in Australia, domestic and international air transport accounts for approximately 65 per cent of the Air Transport Industry in Australia. If domestic and international air transport is 50 per cent foreign owned and the remainder of the industry is Australian owned then approximately 33 per cent of the industry would be foreign owned.

On this basis, the MONASH model assumption that 14.4 per cent of the industry is foreign owned would underestimate the actual percentage of the industry that is foreign owned. This underestimation of foreign ownership would lead to a slight overestimation of the welfare impact of an expansion in tourism, as some of the benefit assumed to flow to Australians from an expansion in tourism would flow to foreigners. However, the majority of the benefits from the expansion in tourism arise through employment effects in the short term and terms of trade effects in the longer term. Thus, overall, we would not expect the underestimation of the share of the Air Transport Industry held by foreigners to lead to a significant overestimation of the multipliers used to value a change in the level of tourism in Australia.

To test this proposition that the underestimation of the share of the air transport industry owned by foreigners would not significantly impact on the multipliers derived from the Monash modelling, the simulation of a \$100 million increase in exports of tourism was re run with the proportion of the industry owned by foreigners increased from 14.4 per cent to 33 per cent. As illustrated in Table 1, the multipliers derived from this simulation are very close to the multipliers obtained from the original simulation

Table 1: Increase in real consumption per dollar increase in exports of tourism

	2003	2000	2005	2006	2007	2008	2009	2010	2011
Original Simulation (14.4% foreign ownership)	1.48	1.09	0.98	0.86	0.80	0.75	0.72	0.70	0.67
New simulation (33% foreign ownership)	1.44	1.07	0.96	0.85	0.79	0.74	0.71	0.69	0.67

Question 7

Section 7 of the NECG Report discusses the future with and without the JSA. With less uncertainty concerning SARS, Middle East conflict and the possibility of ceasing flights to Rome (and their impact on the future supply and demand patterns) than earlier in 2003, please advise a revised modelling of the percentage capacity differences between the factual and the counterfactual.

The NECG Report assumed that SARS and the Middle East conflict would impact air travel in the short term only and as a result these effects were excluded from both the factual and counterfactual scenarios.

Since the NECG Report was submitted, Qantas has suspended its Rome service and as a result has also reduced its Sydney-Singapore-Melbourne services. The necessity of making changes to this latter service is a good illustration of the interrelated nature of Qantas' services and the importance of connecting feeds for viability. Despite these recent schedule changes, Qantas still hopes that, over the longer term, its services to Rome may be able to be reinstated.

However, as requested by the Commission, we have calculated a scenario assuming that these recent schedule changes may be permanent, which results in a capacity difference between the factual and counterfactual of 18% in the long term. Given Qantas' view of the likely factual, the results of this scenario should be considered a lower bound of the possible outcomes. Table 2 shows that even in this conservative scenario the benefits of reauthorising the JSA are substantial.

Table 2: Summary of Australian net benefit estimates, \$ million 2003–2007

	Lost JSA capacity replaced	Lost JSA capacity not replaced
Cost Savings	\$43	\$43
Tourism	\$33	\$286
Net Exports	\$205	\$92
Total	\$281	\$421

14 November 2003