

AUSTRALIAN COMPETITION & CONSUMER COMMISSION

MEETING RECORD

OFFICE: ACCC Melbourne

DATE: 8.30 am 27 November 2003

SUBJECT: Meeting with Qantas and BA in relation to the applications for authorisation lodged in respect of the JSA

ATTENDEES:

Qantas:	Paul Edwards Rob Gurney Brett Johnson Sarah Collins Jill Henderson
BA:	Robbie Baird Niamh McCarthy
Mallesons:	Sharon Henrick
ACCC:	Commissioner Ed Willett (from 8.30-9.30) Tim Grimwade Isabelle Arnaud (video from Canberra) Amanda Dadd David Salisbury Matthew Amor Greg Outzen

The main points raised during the meeting are outlined below.

Mr Johnson noted that the last time the JSA was authorised by the Commission, it was authorised for a period of three years, on the basis that the Commission could consider the JSA together with the Singapore, Air NZ and Ansett alliance when both authorisations expired. Mr Johnson said that this caused significant uncertainty and that the parties would be looking for greater certainty this time.

Mr Johnson said that Qantas and BA wanted to discuss today:

- the issue that midpoint carriers have a competitive advantage over endpoint carriers;
- that the parties do not believe that there is any detriment associated with the JSA, but that there is substantial benefit; and
- that public benefits are already flowing from the JSA and that if the JSA is not reauthorised, these benefits will be lost.

Commissioner Willett asked whether there had been any technological improvements, particularly in relation to the development of long range aircraft, that have resulted in decreases in average seat costs and have impacted on the operation of the Kangaroo Route.

Mr Edwards said that there is no sign that there are any developments likely that will allow significant non-stop travel between Australia and Europe. Mr Edwards said that the introduction of the Airbus A380 will reduce per unit costs.

Mr Outzen said that there have been some improvements in the range of aircraft that facilitate, for example, hub and spoke operation out of the Middle East from Emirates.

Mr Edwards said that the development of those aircraft just allows for a long first sector and a shorter second sector rather than non-stop.

Mr Johnson said that aircraft improvements are opening up more midpoint options and that the Kangaroo Route now encompasses Australia to Europe via Dubai, Hong Kong and Tokyo.

Mr Edwards said that there is strong competition on the Kangaroo Route and that there are many participants on the route.

Mr Outzen said that there is a difference between the number of participants on the route and the number of participants who are 'contenders' in a competitive sense.

Mr Edwards said that there are many 'contenders' and that the airlines on the route do provide effective competition, particularly in terms of providing price competition.

Mr Gurney said that all of the airlines on the route influence other carriers and, while individually they may not represent much in terms of market share, they collectively have a large impact. There is a continuum of price and product (including routing) available and as a result any change initiated by one carrier will impact on other carriers.

Mr Edwards said that, for example, Singapore Airlines operates 70 flights per week into Australia, Cathay 37 and Emirates 35 flights per week. Mr Edwards said that Chinese carriers are 'waiting in the wings' to enter and expand and the Chinese carriers will develop hubs in Shanghai and Guangzhou.

Mr Grimwade asked what the timeframe for the emergence of these carriers is likely to be.

Mr Edwards said that these carriers are likely to emerge within the next three to five years. Mr Edwards said that the cost structure of the midpoint airlines is better than for endpoint carriers because they are all home based. Mr Edwards said that additional costs for endpoint carriers are incurred through staff costs, for example, allowances and accommodation costs, which are higher than for midpoint carriers because of away costs.

Mr Edwards said that most midpoint carriers are government owned and heavily subsidised, including Singapore, Malaysia, Gulf and Emirates.

Commissioner Willett asked how the Commission could take that into account.

Mr Johnson said that it goes to the long term viability of these carriers; Mr Johnson noted that the Commission had expressed some concern in the past as to the likelihood of these carriers remaining in the market; however, it is clear that they will continue to compete.

Mr Baird said that the Government ownership aspect is part of the competitive advantage these carriers have.

Mr Edwards said that these airlines are very important to local communities, for example, Emirates' main objective is to bring people to the UAE.

Mr Edwards said that Qantas and BA need to be able to get bulk to enable them to compete and that the JSA has enabled Qantas and BA to develop a hub in Singapore as a single operation. For example, Qantas and BA's sales people are located in the same building and they are a consolidated business operating as a single entity.

Mr Gurney said that Qantas and BA are integrated operators with individual identities. Mr Gurney said that they are integrated in terms of sales and operations, with jointly branded offices, international teams and reciprocating functions to maximise synergies.

Mr Johnson said that, absent the JSA, Qantas would be disadvantaged because half of its passengers disembark in Singapore and do not fly on to Europe – but with the JSA, the airlines can consolidate traffic from all Australian cities to make operations more viable.

Mr Gurney said that Asian carriers, on the other hand, are able to balance passengers on both sectors quite well.

Mr Baird tabled BA confidential data. Mr Baird said that if a route is to be considered sustainable for the future, the return on sales should be in the order of [confidential information deleted]. Mr Baird said that [confidential information deleted]. Mr Baird said the improvement in March 2002 was due to the Singapore hub effect. The improvement is mainly driven by getting costs down and getting the right capacity in. The services terminating at Bangkok and Singapore [confidential information deleted]. Also, BA were in Perth and Singapore with the same configuration as they had to Asia from Europe – that is, large club class. Economy was full but couldn't fill the rest. Working with Qantas, BA now focuses on city pairs needing that configuration – that is, Sydney and Melbourne. Qantas then flies two class on the other sectors into the Singapore hub.

Mr Baird said that factors influencing capacity and destination decisions include network contribution, market position/share and market potential as well as profitability/return. On many of these parameters, the Australian cities add little.

Mr Outzen said that the [confidential information deleted] figures tabled did not seem to correspond with the confidential figures that have been submitted to the Commission which show [confidential information deleted] for BA over recent years.

Mr Baird explained that changes in aircraft configuration meant that yield and loads combined were not necessarily good guides for revenue. He undertook to provide revenue figures across BA cabins for the periods concerned.

Mr Baird said that the problem for BA is quite clearly the sector beyond Singapore to Australia, where BA is not the natural carrier. The JSA helps particularly on sectors where Qantas and BA are not the natural carriers by creating a critical mass at the midpoint hub.

Mr Edwards said that the JSA has kept BA in the Australian market, which is very important to Qantas and to Australian tourism.

Mr Edwards said that BA's presence in the UK and focus on corporate travel flows on to Qantas and strengthens Qantas' operations.

Mr Edwards said that BA staff in the UK have a greater incentive to sell Australia as a destination and Qantas as part of the JSA because BA comes here and staff understand that, under the JSA, if you sell a Qantas seat, you are selling BA.

Mr Edwards said that if BA didn't go into Australia, the incentives would not be there and any sales would be 'accidental'. Mr Edwards said that BA can sell Australia better because it flies there.

Mr Edwards also said that Qantas and BA have very good inventory management systems and that Qantas can access BA booked customers.

Mr Edwards said that an example of the benefits of the JSA is, by working together, Qantas and BA can operate on a route with two aircraft rather than three. This has occurred with the QF 31/32 service to London which uses 2 aircraft in a 2 day cycle whereas normally 3 aircraft on a 3 day cycle are required. Qantas would not get the load for this service without the alliance. The alliance results in a lower cost base which results in lower fares and benefits to consumers.

Mr Gurney said that the JSA had resulted in a significant boost in tourism.

Mr Johnson said that these are the sorts of benefits that would not arise without the JSA under the **oneworld** alliance.

Mr Baird explained that BA gives Qantas preferential access to seats under the JSA. This benefit would not be available under **oneworld**.

Mr Gurney provided an example of why the JSA provides this benefit in relation to a passenger travelling from Australia to Amsterdam via London. The passenger will arrive in the early morning into London and so will need a peak period flight from London to Amsterdam. The fare class which the passenger is utilising would not be

open on that flight to a oneworld member. However, under the JSA a sale on Qantas is treated as a sale on BA.

Mr Johnson said that, without the JSA, significant capacity would be at risk, as would the significant benefits currently flowing as a result of the JSA. Mr Johnson said that there is very little detriment flowing from the JSA.

Mr Johnson asked what the likely timing of a decision by the Commission would be.

Mr Grimwade said that a decision would be unlikely before early next year.

Mr Johnson said that it may be prudent to have a meeting before then to discuss any other issues or questions that the Commission may have. Mr Johnson asked whether the Commission's views in relation to market definition had changed. He indicated that the Applicants' submissions to the Commission had been based on unchanged definitions.

Mr Grimwade said that the Commission's views in this regard are evolving and that it is unlikely that the Commission will present a view prior to issuing its draft determination.

Mr Outzen said that the Commission was required to respond to the business/leisure distinction that had been put to the Commission by interested parties, it may be prudent for Qantas and BA to consider the desirability of providing material to the Commission about those market distinctions.

Mr Gurney said that the difference in discount business class fares and fares used by business travellers' in the economy cabin is low. Mr Gurney said that the JSA markets are very price competitive.

Mr Baird explained that travellers have a range of options from full first class, to restricted first, to the same range in business including some cheaper fares but with more restrictions, through to world traveller plus to economy. There is the ability for customers to trade off, for example, a cheap restricted business fare for a similar priced unrestricted economy fare or travel in business class but on a different day or different time.

Mr Johnson noted that the Commission authorised the JSA in 2000 for a period of only three years. Mr Johnson said that this had been difficult for the parties because of the uncertainty associated with the arrangements. Mr Johnson asked that the Commission give the parties the longest period of authorisation possible in order to increase certainty. Mr Johnson said Qantas and BA would be comfortable for the Commission to reserve the right to informally review the JSA during the authorisation period.

In relation to Virgin Atlantic's submission, Ms McCarthy said that the CAA data provided does not show passengers travelled – it is survey data with a small sample size. Ms McCarthy said that BA has available other survey data which it regards as more reliable (IPS data) although it is still survey data.

Mr Outzen said that the Commission did not need other survey data as it is relying on data from the Department of Transport that is based on ABS data which the Applicants had supported in submissions.

In relation to the question regarding differences in confidential data provided by Mr Baird and data provided previously to the Commission, Ms McCarthy advised that BA has improved its product and incurred significant cost but now has less capacity per aircraft. BA has yield figures adjusted for both CPI and space per passenger showing yields have come down.

Mr Baird said that yield/RPK, being a per passenger figure does not take into account the total number of passengers. The bottom line hasn't improved.

Mr Outzen noted that BA [confidential information deleted] constantly since 1999/00 – that is, before skybeds and that [confidential information deleted].

Mr Edwards said that Qantas and BA need to provide data relating to average revenue per hull (that is, per flight rotation).

Mr Gurney said that the Commission also needs to look at the cost side of performance data.

Mr Baird said that over that period of time, the number of seats in the market will have changed and the routes flown will have changed. It will be difficult over that period to sort out what caused what. You really need the cost information to see the whole picture.

Mr Gurney said that the major sources of difference between yields on Qantas and BA services were market exposure, currency and product differences.

Mr Gurney said that Qantas in the UK is seen as a leisure carrier, whereas BA is seen as a business carrier.

Mr Outzen said that the Commission's current assessment of the JSA is different from previous assessments because of the consideration of factual and counterfactual scenarios, the opposing submission from Virgin Atlantic and the NECG Report which attempts to quantify many benefits.

Mr Outzen said that staff had looked at projections in relation to future growth and noted that while IATA and others predict market growth of four to six per cent, Qantas and BA predict very low increases in capacity and frequency in the factual scenario. Mr Outzen asked why the growth predicted by Qantas and BA, particularly into the UK, is so small. Mr Outzen asked why there is also a disproportionately large increase in services to continental Europe and, in particular, Paris.

Mr Edwards said that the airlines are trying to build daily frequencies into Europe and then fly passengers onwards. Much of the London traffic does not have London as a final destination – the figure is around 40 per cent.

Mr Edwards said that Paris is a very good corporate market for which a daily service is important. Mr Edwards said that, at the moment, bilateral restrictions limited Qantas from flying more than three services per week, but that an increase in flying rights was hoped for in the future to facilitate increased frequencies into Paris.

Mr Edwards also said that there will be efficiency gains from operating daily into Paris – for example, with flight crew.

Mr Johnson said that an increase in services to Paris will also ‘free up’ seats into London as travellers fly direct to France rather than making an additional stop in London.

Ms McCarthy said that this shows that the airlines look at the market as Australia – Europe and not city pairs.

Mr Gurney said that growth is needed for competitive reasons.

In relation to growth out of Adelaide and Darwin, Mr Gurney said that the airlines are starting from a very low base in Adelaide and that they are expecting significant growth in the Northern Territory as a result of increased tourism marketing.

Mr Edwards said that there was political pressure to support the Australian states.

In relation to growth out of Perth, Mr Edwards said that Perth increases are essentially a result of the move to replace 767 services with A330s. Mr Edwards also said that services out of Perth are linked to increases in services to Paris. Mr Edwards explained that you get the Perth – Singapore service for nothing out of the Paris aircraft and therefore save a 767. You also gain the traffic flow from Perth. Mr Edwards explained that there is no time to go into Melbourne, Adelaide or Sydney using the Paris aircraft, although you could do Darwin.

Mr Edwards said that for the counterfactual the airlines have focused more on the totality of what would be happening into and out of Europe rather than the frequencies of specific city pairs.

Mr Edwards said that the Australian Government is currently trying to negotiate daily Paris service rights.

Mr Outzen noted that Qantas’s seat factors on the Kangaroo Route are around 90 per cent. Mr Outzen asked how difficult this makes it to get a seat to London.

Mr Gurney said that a 90 per cent load factor is still equivalent to 40 empty seats per flight, or 240 empty seats per day.

Mr Outzen asked whether Qantas and BA seek to increase seat factors in first and business class before increasing frequency and whether Heathrow is a constraint for expansion.

Mr Baird noted that for any airline it is the mix of passengers in each cabin class which is important.

Mr Edwards said that, in relation to slot availability at Heathrow, the airlines had recently obtained two additional slots through the normal slot allocation process – that is, from the pool and not from another airline. Mr Edwards said that Virgin Atlantic recently sold a slot to BA.

Mr Baird said that BA's recent slot trade was by way of an open auction. Also, Emirates operate three services from Heathrow and three from Gatwick.

Ms McCarthy said that there had been a number of recent cases in Europe where the view was expressed that there is a London airport market, rather than a distinct Heathrow market, even on short haul routes.

Mr Outzen said that it would be useful if those cases were provided to the Commission. Mr Outzen said that this is important to the Commission in terms of the ability of other carriers to expand.

Mr Baird said that other carriers have already expanded and that there is further opportunity for expansion.

Mr Baird said that Asian airlines have got slots at Heathrow and that Heathrow is not full. Mr Baird said that there is little capacity constraint at Gatwick.

Ms McCarthy said that if it would help improve the Commission's understanding, she was happy to provide the Commission with a paper on slot availability at Heathrow.

In relation to information the Applicants had provided the Commission regarding the availability of fully flexible 'H' and 'M' class tickets, Mr Outzen said that these fares seemed very difficult to purchase on the internet.

Mr Gurney said that this seemed strange but that there are very long lead times to the sale of a lot of fares and that it may be hard to find seats now because a lot of seats were presold at prices lower than the airlines would like because the recovery in demand was not expected until later.

The airlines said that they would be able to provide the Commission with data on seat availability.

Mr Outzen queried whether high seat factors means you can charge more.

Mr Baird said it is about the JSA parties needing to sell those last few seats to break even. BA and Qantas work very hard together to ensure we do sell these.

Ms Collins said that high seats factors illustrate that the JSA is working well as it allows optimisation of loads.

Mr Outzen asked whether other airlines are able to get load factors as high as those on the JSA partners. Mr Outzen also asked whether there is, at some point, an opportunity for the JSA partners to increase fares.

Mr Gurney said that other airlines are probably not running as high load factors but that these airlines are less efficient.

Mr Johnson said that there is ample opportunity for other airlines to operate additional services.

Mr Gurney said that the airlines need high load factors in order to break even and that fares are not set by the JSA airlines, but instead by the market.

In relation to Qantas' introduction of beds in business class, Mr Outzen said that the beds take up 30 per cent more space (that is, the number of business class seats is reducing by 30 per cent), but that there is only a ten per cent increase in price rather than a 30 per cent fare increase.

Mr Gurney said that Qantas had no choice but to introduce beds as a responsive measure. Mr Gurney said that the beds deliver a lower return per square metre, but that the alternative (that is, not introducing beds) would have been worse for the airline. Mr Gurney said that, without beds, Qantas is competing with airlines such as Thai.

Mr Gurney said that the fact that Qantas cannot increase price by more than ten per cent indicates that there is competition in the market.

Mr Baird said that BA's decision to remove economy capacity when it introduced beds was driven by the characteristics of the Atlantic market. The same aircraft are used on JSA routes as airlines can only have a small number of sub-fleets.

Mr Outzen said that there is a lack of detail in the scheduling information presented to the Commission as part of the counterfactual scenario.

Mr Johnson said that the airlines made the decision when putting together the supporting submission that the inclusion of disaggregated schedule information would be inappropriate given the uncertainty surrounding exactly which schedules would be likely to be operated and which would reduce or cease.

Mr Johnson said that NECG had told the airlines that the choice of schedule did not matter a great deal in terms of the modelling of the net public benefits of the JSA.

Ms Dadd noted that it was difficult for the Commission to conduct any effective analysis of the counterfactual in the absence of detailed schedule information similar to what was supplied for the factual scenario.

Mr Johnson said that more detailed counterfactual information, including information on the sensitivity of the model to details of schedules, would be provided to the Commission.

Mr Edwards, Mr Gurney and Mr Baird discussed the benefits of membership to the **oneworld** alliance. It was submitted that there is a perceived consumer benefit of membership which means that airlines cannot afford not to be a member of an alliance, however, **oneworld** is not a substitute for integrated alliances.

Mr Gurney explained that there is no seat availability guaranteed with **oneworld**. BA would have no financial incentive to sell and promote Qantas.

Mr Baird explained that BA looks at profit and network contribution in deciding what to operate. [Confidential information deleted]. Asia is therefore important. However a large number of low yielding passengers go to Australia. Therefore BA's interest in working with Qantas to build the services to Australia would not be there in the absence of the JSA. [Confidential information deleted].

Mr Johnson gave the example of Cathay Pacific – and said that whilst it is in **oneworld**, it is an aggressive competitor so Qantas and Cathay do not do much together.

The meeting concluded at 11.30am.