General Counsel
Brett Johnson

26 February 2004

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)

We refer to your letter of 8 December 2003, Greg Outzen's email of 19 January 2004 and the meetings with the Commission on 16 January 2004 and 3 February 2004.

Set out below are our responses to questions raised in the letter, email and meetings.

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.

Q1 ***It is noted that the latest version of the JSA as supplied to the Commission does not provide any details on the basis on which BA is paid by Qantas for providing services within Europe (including from the UK) under either code share arrangements or on an interline basis.***

Could you please provide details of the relevant payment arrangements and an example of a code share agreement.

Qantas and British Airways entered into a bilateral codeshare agreement on 5 October 1997 (**Codeshare Agreement**).

Under the terms of the Codeshare Agreement, on specific flights operated by each carrier (the **operating carrier**) the other carrier (the **marketing carrier**) may use its own designator code and sell seats using that code. For example, British Airways operates a scheduled service between London Heathrow and Copenhagen using the code BA814. As this route is covered by the Codeshare Agreement, Qantas is entitled to ticket a passenger using a QF code (in this case, QF3814).

The Codeshare Agreement covers services provided on all JSA Routes and the routes listed in Appendix 5 of the applicant's original submission. Payments between British Airways and Qantas for carrying each other's passengers on these codeshare services as well as on other services are governed by the **one**world prorate agreement (the **RAA**). A copy of the RAA was provided to the ACCC (on a confidential basis) on 13 October 2003. In addition, for sales on codeshare services, the marketing carrier is entitled to a Codeshare Commission of [ ] for its selling costs.

Under the RAA, the actual net revenue received from a passenger for travel on a **one**world or JSA interline itinerary is divided between the participating carriers broadly in proportion to the distances which each carrier carried that passenger.

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Payments are made under the RAA in relation to JSA services to ensure that the operating carrier receives revenue for operating that service. The JSA benefit sharing model operates separately from this allocation of codeshare revenue under the RAA.

Table 45 of the NECG Report contains an example of how the prorated fare that British Airways would receive for carrying a passenger between the same two cities varies when those cities form part of a different interline itinerary. It can be seen from this table that, in the absence of the JSA, British Airways is likely to receive a greater amount for carrying a passenger on a short haul sector (eg London-Frankfurt) if that sector is sold on a stand alone basis rather than as part of a long-haul journey. Without the joint incentive created by the JSA benefit sharing model, British Airways would therefore be unlikely to make such capacity available to Qantas passengers, particularly at peak travel times.

One issue that has been raised by the ACCC is to what extent (if at all) would a codeshare arrangement between British Airways and Qantas in the absence of the JSA produce similar incentives and benefits as compared to a situation where a codeshare arrangement exists under the umbrella of the JSA relationship.

Currently, both Qantas and British Airways place their code on each other's services and actively sell each other's services as if they were operated by the marketing carrier.

In the absence of the JSA, the parties would not codeshare on overlapping routes due to the competition and rivalry that would exist. At our meeting of 16 January 2004, it was asked whether the parties would consider a codeshare where British Airways operated only north of the hub and Qantas south of the hub. Apart from the risk of such an arrangement, absent authorisation, potentially contravening the Trade Practices Act, it represents a worse result for consumers than envisaged by the counterfactual and net benefits provided to the ACCC and is not commercially supported by the parties.

In addition to the long-haul routes, a codeshare without the JSA relationship on short-haul European services would not 'fix' the problem of ensuring Australian passengers had preferential access to the British Airways European network, particularly for travel during peak periods. British Airways would not make capacity available under a codeshare if it could receive greater revenue from selling the seats in its own right. It would not be commercially viable for Qantas (as queried by ACCC staff) to offer to pay British Airways a 'premium' to gain preferential access given the narrow margins on the JSA routes, which is a product of the intensity of competition on those routes.

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Q2 ***At page 128 of the NECG Report it is stated:***

"Without the JSA, and thus without benefit sharing, the only benefit that British Airways and Qantas would receive for short haul flights booked as part of JSA itineraries would be the amount that they would be entitled to receive for that flight under the oneworld prorate system under which British Airways would have little incentive to feed passengers on to Qantas services."

Assuming over a specified period Qantas and BA operate equal numbers of flights and carry equal numbers of passengers at the same fare from Australia to the United Kingdom could you please explain (in some detail) how benefit sharing under the JSA makes it more attractive for BA to carry Qantas passengers on short haul flights from the United Kingdom to Europe, than would otherwise be the case. Could you also please advise in terms of the examples in Table 45 of the NECG Report how much additional revenue British Airways would earn on average from benefit sharing over and above the prorated revenue shown in that table. Is it true that the increased revenue for BA would represent revenue forgone by Qantas?

As noted above, British Airways and Qantas apply the **one**world RAA to prorate both codeshare and normal interline fares. The proration of revenue between Qantas and British Airways where British Airways carries a Qantas passenger on one of its European short haul flights is illustrated in Table 45 of the NECG Report.

Under the JSA, British Airways and Qantas have also agreed to share the '**net benefits**' of operation of all JSA Routes on the basis of the proportion of total capacity on JSA Routes operated by each of Qantas and British Airways. The net benefits are determined in accordance with formulas set out in the JSA benefit sharing model which take into account costs as well as revenues of the parties.

Since the JSA benefit sharing model shares net benefits on all JSA Routes over a year, rather than revenues on an individual flight or incremental passenger basis, it is difficult to state exactly how the distribution of revenue in the example in Table 45 of the NECG Report will ultimately evolve under the JSA. Our letter of 13 October 2003, therefore did not attempt to do this as we had concerns it would misrepresent the operation of the JSA benefit sharing model.

Given your additional request that we advise the ACCC of the additional revenue British Airways would earn from benefit sharing using the example in Table 45, we have set out below a rough estimate of this by allocating the revenues in the proportions that the net benefits are likely to be allocated. However, it is important to reiterate that in practice it is the net benefits on all JSA services over a year which are allocated and not revenues from incremental sales or on individual routes or flights.

Using last year's results as an example, British Airways received approximately [redacted] of the net benefits from operation of Qantas and British Airways' services on JSA Routes. On that basis, in the London-Frankfurt-Singapore-Sydney example in Table 45 where Frankfurt to Sydney is flown by Qantas, the approximate revenue British Airways would have received is as follows:

[redacted]

Accordingly, in the example shown in table 45, if British Airways were not to make a London-Frankfurt seat available to the discounted Qantas passenger and simply sold a London-Frankfurt fare, British Airways would only earn revenue of [redacted]. British Airways therefore makes an additional [redacted] in revenue from making the seat available to the Qantas passenger. The profit that British Airways receives from the JSA outweighs the profit it would earn on the London-Frankfurt sector alone.

However, in the absence of the JSA, if British Airways were to make the London-Frankfurt sector available for the Qantas passenger, British Airways would earn no revenue from the Frankfurt-Sydney sector and [redacted] from the London-Frankfurt sector. British Airways would then be better off not making the seat available for the Qantas passenger as it could earn [redacted] in revenue on a London-Frankfurt fare. If the seat is not made available for the Qantas passenger by British Airways, Qantas will lose the passenger on its Frankfurt-Singapore services. This demonstrates how vital the JSA is in providing feed to Qantas' European services.

Under the JSA it is not correct to consider an increase in revenue to British Airways as representing revenue forgone to Qantas. British Airways and Qantas have a joint interest in promoting the total amount of revenue attributable to the JSA Routes and are indifferent to whether a passenger flies on one carrier's aircraft or the other. This is because irrespective of whether a passenger flies on either British Airways or Qantas on the JSA Routes, each carrier receives a proportion of the net benefit from those routes. Both Qantas and British Airways have the incentive to increase the total number of passengers they carry on the JSA routes.

Q3 ***Is the JSA revenue neutral for BA on long-haul flights? For example while BA may retain [redacted] of the revenue from Qantas operated flights, BA will forgo (to Qantas) [redacted] of the revenue generated from BA operated long-haul flights. Is it correct that the only benefits from the JSA come from the additional passengers who may not fly or increased yield that comes from the JSA?***

The benefit sharing model under the JSA ensures that British Airways and Qantas treat the JSA services as a truly integrated and joint business. As both share proportionately in the total revenue and costs, Qantas and British Airways have a shared incentive to grow the overall profitability of the JSA business by increasing revenue and decreasing costs. British Airways does not get a financial advantage from booking passengers on British Airways services in preference to Qantas services or vice versa. In this sense, it is correct to consider that whether a passenger chooses to travel on either British Airways or Qantas on the JSA routes will have a neutral effect.

What, however, is more important from the authorisation perspective is how the JSA helps British Airways and Qantas provide a better consumer service and to compete against the strong mid-point carriers, such as Emirates and Singapore Airlines, which are able to draw upon passenger feed from their home base to support services to both Australia and Europe.

The two sector nature of the JSA routes for British Airways and Qantas makes it difficult to gain sufficient feed of passengers to support their services south of the mid point (in British Airways' case) or north of the mid point for Qantas. This is due to the number of passengers whose journey ends at the mid point, but also because both British Airways and Qantas are not regarded as a 'natural' provider of transport beyond the mid points. For example, in BA's experience European travellers will instinctively consider British Airways as a potential carrier for services between Europe and Asia. They rarely, however assume that British Airways operates beyond this hub to Australia.

Qantas has the same problem in the opposite direction.

The JSA helps to address this perception by ensuring that British Airways and Qantas' sales force have an incentive to promote and strengthen each other's services in markets where they have less of a commercial presence. By balancing passenger flows in such a way, British Airways and Qantas together are able to sustain more flights together than the sum of what they could sustain separately. Consumers benefit from this joint distribution as it ensures greater capacity and choice in the Australia to Europe market.

In addition, the JSA allows both British Airways and Qantas to address their cost disadvantages from having to use a mid-point hub which is not in either carrier's home base. Aviation technology and work place requirements mean that on a route of this length (in excess of 20 hours), any flights between Australia and Europe must stop en-route to refuel and for the crew to change. As this mid point is not the natural home base of either airline, both carriers incur greater costs (such as accommodating crew) than a mid point carrier. Joint operations through the JSA help to alleviate this problem by increasing efficiencies and economies of scale.

We trust that these responses are of assistance. If you have any further queries arising out of these responses, please contact Jill Henderson on 9691 5799.

Yours sincerely

Brett Johnson
General Counsel

cc Roger Featherston
Mallesons Stephen Jaques