

General Counsel
Brett Johnson



12 March 2004

Mr Ed Willett
Commissioner
Australian Competition & Consumer Commission
470 Northbourne Avenue
Dickson ACT 2602

Dear Mr Willett

**Qantas Airways Ltd (Qantas) and British Airways Plc (British Airways)
Application for Reauthorisation of Restated Joint Services Agreement (JSA)**

Thank you for meeting with representatives of Qantas and British Airways on Tuesday 3 February 2004.

During the meeting, the Commission indicated that it is exploring whether the application for Reauthorisation of the JSA should be assessed on the basis that there is a distinct point-to-point market between cities in Australia and London Heathrow for passengers having a business purpose and travelling in the premium cabin on unrestricted tickets. Virgin Atlantic has made a submission to the Commission to this effect.

As previously explained, the Applicants believe, given the particular features of the JSA routes, that the relevant market for analysis is the market for provision of passenger air services between Australia and Europe.

The relevant issue to address when considering market definition is the willingness of price sensitive passengers (almost all) to switch carrier or type of ticket rather than accept a price increase. On the very competitive JSA routes, even a small loss of revenue would render any price increase unprofitable.

To establish the existence of a distinct point-to-point market between cities in Australia and individual cities or airports in Europe (such as London Heathrow) for passengers having a business purpose and travelling in the premium cabins on unrestricted tickets, the parties would need to have the ability to raise prices to those passengers secure in the knowledge that:

- (a) even a marginal number of those passengers would not decide to fly on a competitor; and
- (b) competitors wouldn't maintain their existing fares while increasing their supply of tickets of this type.

For the reasons set out more fully below, Qantas and British Airways do not have this power.

Geographic Market Issues – Point-to-Point v. Country-to-Region

The Kangaroo Route is amongst the longest commercially operated routes in the world. Business executives, to whom time very important, lose several days in travel and recovery time on each trip they make to/from Europe. As a result, they typically seek to maximise the value of such journeys by planning and structuring them to visit multiple clients in multiple cities. Similarly, leisure travellers typically visit multiple destinations on any trip to Europe.

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This means that, in contrast to most short and medium haul flights, a high proportion of both business and leisure travellers from Australia to London Heathrow or anywhere else in Europe visit multiple cities. For example, Qantas data shows that approximately half the passengers on Qantas flights from London Heathrow to Australia come from other cities in Europe. For such travellers, a flight from Australia to any of the cities they plan to visit will be almost perfectly substitutable for a flight which takes them to London Heathrow or any other city on their itinerary as their initial European entry point.

Europe also benefits from a dense short haul connecting flight network and excellent high speed road and train connections. This means that a high proportion of passengers to Europe travel via a gateway airport other than their ultimate destination. This may add a couple of hours to total travel time but, in the context of a 22 or 24 hour flight, this is not critical and is less important than issues such as comfort. Flights to one European gateway are therefore highly substitutable with flights to other European gateways.

The resulting regional nature of the market for flights to UK/Europe and the high degree of substitutability between flights within that region is evidenced by the fact that airlines generally common rate their fares from Australia to all destinations in Europe. This is in recognition of the fact that, from Australia, it is pointless charging more for flights to one European destination than another as all this will achieve is diversion of traffic to another gateway.

Even if a city pair market analysis were to be adopted, it is clear that the JSA has not lessened competition in any market. For example, ABS data shows that the highest share of traffic held by the Applicants on any city pair is 45% between Sydney and London. This share has reduced from 48% at the commencement of the JSA, whilst over the same period Singapore Airlines' share has increased from 8% to 17%.

Customer Market Issues – Business v. Leisure Travellers

The Applicants do not believe it is possible on any basis to distinguish a separate market for business purpose travellers. Routes between Australia and Europe are primarily leisure routes, with only a very small percentage of passengers travelling for business purposes. As previously indicated, according to ABS data only about 12.8% of passengers between Australia and Europe have a business purpose when they travel.

Whereas in the past, certain business travellers may have been viewed by regulators as relatively price insensitive compared to leisure travellers, that position is no longer correct. Corporations are demonstrably cost conscious when purchasing travel, requiring their employees to travel on the carrier offering "the cheapest fare on the day", to downgrade cabins depending on the nature of their trip or to take alternative routings to save costs.

This is reflected in the fact that both the premium and economy cabins will typically contain a mixture of both business and leisure passengers. For example, Qantas research shows that its business passengers are divided almost evenly between the economy and premium cabins. British Airways' research shows that only around 40% of passengers travelling in its premium cabins from the United Kingdom to Australia are travelling for business.

Product Market Issues – Restricted v. Unrestricted and Premium v. Economy Tickets

Routes between Australia and Europe can be easily distinguished from short haul routes within Europe or between Europe and the Eastern Seaboard of the United States, where competition authorities have distinguished an economically distinct group of "time sensitive" passengers who place a higher value on fully flexible tickets.

Typical fare restrictions such as Saturday night stay rules and restrictions on the ability to change to different flights on the same day present little barrier to substitutability to most business travellers in the context of extreme long haul travel between Europe and Australia, where even business travellers plan their travel in advance and normally stay for at least several days or a week.

In addition, even relatively highly discounted tickets between Australia and Europe tend to offer highly flexible fare rules, making it possible for a high proportion of business travellers to substitute discounted fares for less discounted fares. Therefore, in the context of the JSA routes, it is not correct to draw any clear distinction between 'flexible' and 'restricted' fares as a proxy for distinguishing between types of passengers.

As you know, when defining a market it is necessary to consider to take into account both demand and supply side substitutability. Where a high degree of supply side substitutability exists between two products such that the supply of one can be quickly and freely substituted for the supply of the other, the two products should be considered to be in the same market.

It is difficult to contemplate more perfect supply side substitutability than that which exists between fully flexible and the various degrees of less flexible air tickets. Airlines around the world create whole alphabets of fare types, each with minor differences to the other. They then employ teams of analysts and spend millions of dollars on yield management and inventory systems to detect emerging differences in profitability between each fare type and adjust relative availability of each on a daily (or more frequent) basis.

As described at pages 41 to 43 of the NECG Report, high degrees of supply side substitutability also exist between the premium and economy capacity made available on these routes. Given this high degree of supply side substitutability, flexible and less flexible fares and premium and economy class tickets must all form part of the same market.

The factors identified above clearly support the view that the appropriate market for analysis of the application for reauthorisation of the JSA is a regional market for flights between Australia and Europe for all passengers – not distinct point-to-point city pair markets or separate markets for business purpose travellers, 'fully flexible' tickets or premium cabin tickets.

Nevertheless, even if the ACCC chooses to analyse the JSA through the lens of any of these narrow market definitions, Qantas and British Airways believe this will not change the fact that, overall, the substantial public benefits associated with the JSA outweigh the competitive detriment (if any).

I trust this information will be of assistance to the Commission. Please do not hesitate to contact me should you have any questions or wish to discuss any aspect of this letter further.

Yours sincerely



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cc: Roger Featherston, Mallesons Stephen Jaques

Annexure

Europe - Treatment of Time Sensitive Travellers

To date, the Competition Directorate of the European Commission (EC) has distinguished between different customers, but this has been on the basis of time-sensitivity rather than a purposive (business/leisure) approach.

The EC's position was succinctly summarised in *Austrian Airlines/Lufthansa* (Case No. COMP/37.730) which stated that, "[time-sensitive customers] wish to reach their destination in the shortest possible time, they are not flexible in terms of time of departure/arrival and they need to have the option of changing their reservation at short notice. Non-time-sensitive customers, on the other hand, are more price-sensitive and accept longer journey times."

The EC has noted, as a generalisation only, that business travellers are more time-sensitive than leisure travellers. However, the EC has made it clear that it sees any distinction based on travel purpose as no more than a rough proxy for time sensitivity. For example, in *SAS/Maersk Air* (Case No. COMP/37.444), the EC stated that, "The distinction between business and leisure travellers does not coincide with the difference between time-sensitive and non-time-sensitive passengers. For example, leisure travellers going to their destination for a week-end or city trip will prefer not to spend a substantial part of their leisure time travelling in more time consuming means of transport." (See also Case No. COMP/38.479 - *British Airways/Iberia/GB Airways*).

The EC has not been required to determine whether the distinction between time-sensitive and non-time-sensitive customers is sufficient to justify distinct market definitions, and has therefore left the question open. However, the EC has noted a blurring of the distinction in any event, particularly on long-haul flights, as criteria other than flight duration play an important role in even time-sensitive passengers' decisions (see Case No. COMP/M.2041 - *United Airlines/US Airways*).

United States - Treatment of Time Sensitive Travellers

U.S. competition authorities also distinguish between passengers on the basis of time-sensitivity. The distinction most frequently arises in the context of a decision about whether the availability of connecting service between two cities will discipline the fares offered for non-stop service. A time-sensitive traveller is relatively less willing to switch to connecting service in response to a rise in non-stop fares, and therefore is viewed as more vulnerable to concentration in the non-stop market. See, e.g., Order to Show Cause in *Joint Application of Delta Air Lines, Inc., Societe Air France, Alitalia-Linee Aeree Italiane-S.P.A., and Czech Airlines Under 49 U.S.C. §§ 41308 and 41309 for Approval of and Antitrust Immunity for Alliance Agreements*, U.S. Dept. of Transportation, Order No. 2001-12-18 (Dec. 21, 2002) [hereinafter, "*Delta Order to Show Cause*"]; Order to Show Cause in *U.S.-U.K. Alliance Case*, U.S. Dept. of Transportation, Order No. 2002-1-12 (Jan. 25, 2002) [hereinafter "*U.S.-U.K. Alliance Case*"]. While the U.S. Department of Transportation (DOT) recognises that most time-sensitive passengers are business travellers and most non-time-sensitive passengers are leisure travellers, the distinction for purposes of market definition is based squarely on a passenger's willingness to pay more for a shorter trip, and not on whether the passenger is travelling for business or pleasure. *U.S.-U.K. Alliance Case*.

Moreover, when the DOT needs to identify time-sensitive passengers for purposes of defining the limits of an antitrust immunity order, it uses as a proxy the type of fare purchased. The passenger's purpose of travel (for business or for pleasure) is not a factor. This issue arises where the DOT has found that time-sensitive passengers in a specific city pair would be harmed by the grant of immunity to airlines offering non-stop service between the cities, whereas non-time sensitive passengers would not be. To protect the time-sensitive passengers in this situation, the DOT has developed a standard carve-out to its immunity orders. The carve-out provides that the grant of immunity does not apply to activities "with respect to unrestricted coach class fares or any business or first-class fares for local U.S.-point-of-sale passengers flying non-stop between" the two relevant cities. E.g., *Delta Order to Show Cause*; Final Order in *Joint Application of Delta Air Lines, Inc., Societe Air France, Alitalia-Linee Aeree Italiane-S.P.A., and Czech Airlines Under 49 U.S.C. §§ 41308 and 41309 for Approval of and Antitrust Immunity for Alliance Agreements*, U.S. Dept. of Transportation, Order No. 2002-1-6; *U.S.-U.K. Alliance Case*.