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29 June 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
Applications for Reauthorisation of Restated Joint Services Agreement (JSA)

I refer to the recent discussions between Jill Henderson and Greg Outzen when Qantas was invited to update the Commission about recent capacity decisions which may be relevant to the ACCC's review of the JSA. We also take this opportunity to formally respond to Paul Palisi's letter dated 24 December 2003.

This letter and its attachments 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, Qantas and British Airways 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 or around the heading of a confidential table or graph.

Capacity Additions on the Kangaroo Route

As foreshadowed at meetings between the Commission and Qantas/British Airways representatives on 16 January and 3 February 2004, Qantas recently acquired two pairs of daily slots at Heathrow Airport. At the time of those meetings, Qantas was in the process of considering how to best utilise the slots. This included consulting with its alliance partner British Airways. Qantas has announced its intention to utilise the first daily slot by increasing its services to the United Kingdom from 21 to 28 per week over the next two years.

Qantas applied to the International Air Services Commission (IASC) for seven available units of capacity to the United Kingdom so as to give effect to its announced increases. The IASC awarded Qantas four of these capacity units on 1 April 2004. The three remaining capacity units are the subject of a competing application by Backpacker Xpress Pty Ltd submitted on 24 March 2004.

On 18 May 2004 Qantas applied to the IASC for seven units of fifth freedom capacity between Hong Kong and London. Four of these services are available for immediate use whilst the additional three will become available from April 2006.

If Qantas is successful in its applications to the IASC, it plans to introduce six new weekly services between Australia and London from November 2004 comprising:

- 3 x PER-SIN-LHR; and
- 3 x SYD-HKG-LHR.

The seventh additional London service is expected to commence in November 2005 and will be routed via Hong Kong.

[Confidential information deleted.]

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Further decisions about how Qantas will utilise the second daily pair slot will reflect market and other developments and will take into account the availability of additional Hong Kong to London capacity from April 2006. In the meantime, Qantas has the option of using the slots for short-haul Qantas services and is in the process of making arrangements for the Northern Winter 2004 season.

These developments confirm Qantas' commitment to developing and enhancing its service offerings on the Kangaroo Route. For the first time, consumers will have the benefit of travelling on JSA services to Europe via Hong Kong or through the existing mid points including the Qantas/British Airways "mini-hub" in Singapore.

Suspension of Qantas Services to Paris

Qantas has announced that effective from 31 October 2004 it will suspend operations from Australia to Paris.

Over the past few years Qantas has devoted significant effort and resources to persuading the French Government to increase the rights available to an Australian designated carrier under the respective Australia-France Air Services Agreement from three to seven services per week. Qantas hoped that increased frequency would improve the profitability of the service which has historically been loss making.

It has become increasingly apparent that Qantas would not be able to improve the profitability of its Paris services by increasing frequency due to regulatory constraints. Other factors such as the leisure nature of the route and seasonal nature of traffic flows have meant that Qantas has been unable to consistently generate sufficient yields and seat factors to cover costs and provide a return on investment. For these reasons, Qantas has made the strategic decision to withdraw from the route.

Since making this decision, Qantas has looked at a range of options which would allow it to maintain a marketing presence on the Australia to France route and has reached agreement with Air France for Qantas to codeshare on Air France daily flights from Singapore to France. Air France will codeshare on Qantas JSA services between Singapore and Australia.

Qantas believes that this will benefit Australian consumers as it will allow passengers from a range of Australian ports to travel to the Singapore "mini-hub" where they will join an Air France operated flight to Paris. Qantas also benefits from the ability to market a daily service to France at the same time as feeding Qantas services to London and Frankfurt through Singapore.

Impact Upon JSA Re-Authorisation

The Commission will recall that at the time of lodging our current application for re-authorisation Qantas stressed that the JSA was an important means to allow Qantas and British Airways to compete against strong mid-point carriers such as Emirates, Cathay Pacific and Singapore Airlines. In particular, the JSA provided for both Qantas and British Airways to provide valuable and essential passenger feed to each other's services beyond the first stop journey.

Qantas' recent decision to suspend services from Singapore to Paris (together with its decision to withdraw services from Singapore to Rome from September 2003) illustrates the susceptibility and marginal nature of operating services away from each carrier's natural base. There is no doubt that without the JSA, Qantas would have been forced to withdraw these services earlier.

Whilst Qantas is committed to developing mid-points between Australia and Europe (such as Hong Kong) the recent capacity additions demonstrate that this growth is not at the expense of the Singapore 'mini-hub'.

As stressed on numerous occasions, the fact that Qantas and British Airways operate a joint business on the Kangaroo Route gives each party the incentive to support and grow the profitability of each carrier's services. Without the JSA, neither Qantas nor British Airways could maintain the breadth and depth of their network in an intensely competitive environment.

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Response to Paul Palisi's Letter dated 24 December 2003

1. ***Could you please advise the percentage of passengers travelling on JSA services in 2002 with origins/destinations in each of (i) South East Asia, (ii) continental Europe and (iii) the United Kingdom who were members respectively of the Qantas and BA frequent flyer schemes.***

We do not have this data on an origin and destination basis but can provide the following data in relation to the proportion of passengers on particular sectors of JSA Services during the 2002 calendar year who were members of the Qantas Frequent Flyer program or of the British Airways Executive Club. This data includes all passengers travelling on relevant sectors, irrespective of their ultimate origin or destination.

[Table 1 – Confidential information deleted]

2. ***After 1 January 2004 will there be any difference between the Qantas and BA schemes in terms of the basis on which points/miles are earned across the various categories of fare types? It is noted for example that the BA website states that Executive Club benefits do not extend to customers who only fly on restricted fares.***

Yes. British Airways made significant changes to its Frequent Flyer program in July 2003. Following those changes, BA Executive Club members travelling on discount economy fares earn points at the rate of 25% of the miles travelled, rather than the 1 point per mile applying to full economy fares (booked in Y, B and H classes). This applies whether the member is travelling on a BA or Qantas code. As a result, the Qantas Frequent Flyer program was changed with effect from 1 January 2004 so that Qantas Frequent Flyer members travelling on JSA flights under a British Airways designator in specific economy classes earn points at the rate of 25% of the miles travelled. However, Qantas Frequent Flyer members travelling on JSA flights under a QF designator continue to receive one point per mile, regardless of the fare class.

Similar restrictions apply to flights on other oneworld partners, with American Airlines and Cathay Pacific having fare classes on which no points are earned and American Airlines having a lower rate of earning for some discount economy fares. These restrictions apply when Qantas Frequent Flyer members fly on flights marketed by those oneworld airlines.

The British Airways changes also included a restructure from five regional chapters into one global program. As part of the restructuring, the South West Pacific British Airways Executive Club program has been shut down and members have been offered the possibility to migrate to the Qantas program. This decision was based on the fact that because overall the program had a small number of members, only a fraction of whom were active members (less than [confidential information deleted]), the costs of the program clearly outweighed the benefits to British Airways.

3. ***It is noted that eligibility for membership of the BA scheme is restricted to persons who have booked or taken at least full economy fare travel and that non-residents of the UK do not necessarily qualify for membership. Australian residents for example cannot join the BA scheme. Are there any similar residency restrictions on membership of the Qantas frequent flyer scheme?***

No.

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4. ***In terms of flights operated under the JSA, are there any restrictions [either through the marketing process, yield management or for other reasons] on individual flights on the number of seats allocated to either the Qantas or BA designators. Is it possible for example for all seats on a BA operated flight to have Qantas flight codes if that is what passengers have requested?***

Provided Qantas complies with the terms of its IASC determinations, there are no restrictions on the number of seats allocated to either the Qantas or BA code on JSA services.

5. ***How many residents of the United Kingdom are members of the Qantas frequent flyer scheme?***

There are approximately [confidential information deleted] UK resident members of the Qantas Frequent Flyer program, of which approximately [confidential information deleted] are active members (ie, they have had some activity in the previous 12 months).

6. ***To what extent would the changes to the Qantas scheme being implemented from 1 January 2004 and the differences in eligibility requirements of the two schemes be expected to affect consumer choice between flights of Qantas and BA under the counterfactual?***

If the changes to BA's Frequent Flyer program affect consumer choice and incentivise customers to fly on a QF rather than a BA marketed flight, this would be likely to have very little effect on the factual scenario as passengers will be able to fly on a QF code on BA operated flights and still earn points at the rate of 1 point per mile.

However, in the counterfactual scenario, Qantas and BA would not be codesharing on each other's flights. To the extent that the changes to BA's Frequent Flyer program incentivised customers to fly on a QF rather than a BA flight, this would be likely to reduce traffic flows to British Airways.

It is questionable whether any such a reduction in traffic flows would be significant. Frequent flyer programs are only one element in terms of customer choices. Other important factors driving passengers' choice of airline on any particular route will include price, flight schedule, product and quality of service and in the case of business purpose travellers will include corporate and government mandated travel policies. In the context of the JSA, given that the Kangaroo Route is amongst the longest commercially operated routes in the world, quality of service and on-board comfort play a particularly important role in influencing passengers' choice of airline.

Please let me know if you have any further queries in relation to these matters.

Yours sincerely



Brett Johnson
General Counsel

cc Roger Featherston
Mallesons Stephen Jaques