virgin atlantic

AUTHORISATION APPLICATIONS BY QANTAS AIRWAYS LTD. AND BRITISH AIRWAYS PLC (A30226 & A30227)

Supplementary Submission

- Virgin Atlantic agrees with much of the analysis contained in the ACCC's Draft Decision. Indeed, to a significant extent the analysis coincides with the arguments previously advanced by Virgin Atlantic. Unfortunately, the analysis does not support the Draft Decision's ultimate conclusions.

- In particular, we agree with the ACCC's analysis that:
  - there are two separate relevant markets representing time sensitive and less time sensitive passengers, characterised in the Draft Decision as the business and leisure markets;
  - the relevant markets are city-pairs, and in this particular case it is not necessary to consider airport-pairs;
  - there is considerable doubt about many of the claimed benefits of the JSA presented by Qantas and British Airways and about the effects on the relevant markets and parties if the JSA is not approved;
  - the JSA clearly has anti-competitive elements and approval of it would not be in the interests of business passengers;

- airlines' supply of services (to both high yielding and economy passengers) is correlated closely to demand from high yielding passengers rather than economy passengers (and hence outcomes in business markets will affect outcomes in leisure markets);
- the JSA will (therefore) lead to constraints in the supply of economy capacity between Australia and the UK; and
- there are substantial barriers to market entry, for example a marked shortage of slots at London's Heathrow Airport.

➢ The existence of the JSA has contributed significantly to the delay in Virgin Atlantic entering the Australia-UK market, and has probably been a factor in the withdrawal of the European airlines which previously served Australia. Virgin Atlantic is now prepared to enter this market because of the increased recognition of the Virgin brand in Australia and the availability of bilateral fifth freedom rights between Hong Kong and Sydney which would almost certainly be lost if not taken up by Virgin Atlantic at an early date. [The Commission may wish to note that since the hearing the European Commission has indicated provisional approval to the recent bilateral agreement between the UK and Hong Kong for a 12-month period, subject to final approval by the full European Commission.] Nevertheless, Virgin Atlantic remains concerned about the potential anti-competitive impact of the JSA on its new service between Sydney and London.

- The business market is extremely important for airlines:
  - as the ACCC notes, it accounts for between 10.5% and 16.3% of passengers travelling on routes between Australia and the UK. However, these figures considerably underestimate the market's true size and importance. It is more relevant to consider the value of the market in terms of the total prices paid by business passengers. The ACCC's *Merger Guidelines* would appear to concur with Virgin Atlantic's view (5.100): "Market shares may be calculated with reference to capacity, sales volumes or sales values... The Commission will place greatest weight on data which best reflects firms' future competitive significance. Capacity figures may be particularly useful as an indicator of market power in markets for undifferentiated products. However, sales figures provide a better indication of firms' actual position in the market, which may reflect their access to distribution networks or the value of brand loyalty. The dollar value of sales is a particularly useful indicator of competitive strength in markets characterised by product differentiation and brand loyalty".

There is considerable precedence for adopting such an approach. For example, in *Re Queensland Independent Wholesalers Ltd* (1995) 132 ALR 225, the accepted measure of market share in the Australian wholesale grocery market (and the measure adopted by the court) was the proportion of branded packaged groceries sold in Australia, according to the statistics compiled by the trade journal *Retail World* - a market share based on value.

The value of the market can be easily measured, to a sufficient degree of accuracy, with the assistance of data from Qantas, BA and a handful of other airlines (as discussed further below, in practice the vast majority of passengers use only a handful of airlines to travel between Australia and the UK);

- the importance of the business market is indicated by the fact that its absence would almost certainly mean the withdrawal of Qantas and BA, and indeed Virgin Atlantic, from Australia-UK routes. Such routes would simply not be viable if the airlines concerned had to rely solely on leisure passengers. To that extent, what happens in the business market affects what happens in the leisure market (but not vice-versa). The ACCC's analysis in its Draft Decision appears to support this view: "... it appears to the Commission that supply side growth has been driven by changes in the demand characteristics of high yielding passengers rather than of economy passengers" (para. 9.44);

- Qantas and BA together have some 60% of the Australia-UK business market, and almost 70% of the Australian-originating business market. That is clearly a dominant position. As the ACCC notes in its Draft Decision (para. 10.72): "...joint market shares at such levels raise competitive concerns and would be expected... to potentially impact on price, service and product choice";
- and that is precisely what has happened. Four developments in particular highlight the anti-competitive market power enjoyed by Qantas and BA:
    - Qantas has stated that it intends to apply a 10% surcharge to fares to recoup its investment in new Business Class seats, an initiative described by the ACCC as typical of a "cost-plus" approach to charging. Virgin Atlantic has recently invested a substantial amount of money in new seats, yet has not been able to impose a fare surcharge on a single route because of the competitive nature of the markets in which it operates;
    - the ACCC has also noted that the JSA has enabled Qantas to delay the introduction of new Business Class sleeper seats. Virgin Atlantic is about to complete the second product cycle of such seats, having initially introduced them several years ago. In the business market product is a key competitive tool.

It is evident that unlike most other major airlines, Qantas does not feel under any significant competitive pressure in the business market;

- when six pairs of peak Heathrow slots became available, Qantas bought two and Virgin Atlantic four. However, Qantas paid twice the amount per slot than Virgin Atlantic did. It could only do this because it is able to pass on the additional cost in the "cost-plus" JSA environment in which it operates;
- as the ACCC notes in its Draft Decision: "Premium cabin fares have risen substantially during the term of the JSA [para. 11.30] ... [such fares] are likely to increase in the future [with the JSA]" [para. 11.16]. The ACCC clearly doubts that, despite claims to the contrary by Qantas and BA, any cost savings from the JSA will be passed on to business passengers;

- in short, there is ample evidence that Qantas and BA enjoy market power in the business market;
- given that (in light of the nature of supply) what happens in business markets affects leisure market outcomes, Qantas and BA's dominance of Australia-UK business markets will affect Australia-UK leisure market outcomes. Indeed, the ACCC states in its analysis: "the Commission is of the view that it is likely... under the JSA if authorised, that the Australia-UK routes would be significantly constrained in terms of the supply of economy capacity to the market" (para. 9.43).

However, this finding is not reflected in the ACCC's ultimate conclusions on Australia-UK leisure markets. On page iii the ACCC states: "the United Kingdom business passenger market is the only market where the lessening of competition currently seems likely to be substantial".

- The ACCC concludes that there is a "fine balance" between competitive detriment and public benefit from the JSA. There are benefits in the leisure market, but disbenefits in the business market. Overall, the ACCC finds marginally more benefits than detriment and has indicated therefore that it is minded to approve the JSA. But surely a much better approach would be to keep the perceived benefits while at the same time seeking to remove the disbenefits. This could be done quite easily by attaching conditions to the JSA. Such an approach would be consistent with that taken by other competition authorities, those in Europe and the United States for example, when considering similar applications by airlines. There are numerous such examples. It is not a radical policy, and one supported by BA in its submission to the Canadian authorities in connection with Air Canada's acquisition of Canadian Airlines: "An approach similar to that proposed has been adopted by authorities in a number of jurisdictions, including Australia, South Africa, Europe and the United States" (British Airways, *Competition in the Canadian Airline Industry: Bill C-26,* Summer 2000). BA goes on to quote extensively from decisions taken by the European Commission in respect of KLM/ Alitalia, Lufthansa/ SAS, and *British Midland v Aer Lingus*.

- BA has a history of anti-competitive activity. It sought to prevent Virgin Atlantic's early expansion by acting illegally (the so-called "dirty tricks" campaign). It has been found guilty of illegal activity in the UK market for travel agency services by the European Commission (confirmed by Europe's second highest court) and fined heavily. It is currently under investigation by the UK's Office of Fair Trading for alleged anti-competitive behaviour in the market for corporate sales. The OFT has concluded that BA has a *prima facie* case to answer.

- There must similarly be a real risk that Qantas will react to Virgin Atlantic's entry to the Australia-UK markets by resorting to dubious actions. For example, despite Qantas' assurance to the Commission that it had no plans to increase Australia-UK frequencies, the announcement that Virgin Atlantic would enter the markets was quickly followed by a declaration that Qantas intended to add 14 more round-trip frequencies per week, twice what Virgin Atlantic plans to operate.

- Virgin Atlantic's ability to compete effectively in the Australia-UK markets is critically dependent on there being fair competition. Virgin Atlantic has never shied away from competition. We are not seeking unnecessary protection. We have repeatedly shown that we are able and willing to compete with anyone, no matter how big and ugly, provided we are given the opportunity to do so.

The Qantas/BA JSA poses a major threat to fair competition. It is the duty of competition authorities to ensure that the parties to the JSA cannot abuse their dominant positions to harm competitors. Such action needs to be taken by the ACCC before, not after, other airlines are forced out of the markets.

- This is why Virgin Atlantic is proposing that certain restrictions should be imposed on Qantas and BA with respect to the business market as a condition for the approval of the JSA. This is not intended to prevent competition. Quite the opposite: it will ensure that competition can be fair and effective. The fact that in very similar circumstances BA itself proposed just such an approach in Canada when Air Canada sought to acquire Canadian Airlines must surely be highly relevant.

- Virgin Atlantic urges the ACCC to consider the application of the conditions included in Virgin Atlantic's original submission and in its "speaking notes" for its pre-determination conference presentation to the JSA parties. These are:
    - Airport access: Qantas and BA must make available a sufficient number of slots at Heathrow at competitive timings;

- Corporate Deals: Qantas and BA must not be allowed to tie discounts on travel between Australia and the UK to discounts on travel on other routes (for example, Qantas must not be allowed to make the offering of discounts on e.g. travel within Australia dependent on also obtaining corporations' business on Australia-UK routes);
- Frequent Flyer Programmes (FFPs): Frequent Flyer points awarded by Qantas and BA for travel between Australia and the UK must not be added to points awarded for travel on other routes for the purposes of determining rewards, or Qantas and BA must grant access to their FFPs to any competitor seeking such access, on terms no less favourable than those applicable to any other participant, including Qantas and BA;
- Travel agency commissions: Qantas and BA must not be allowed to tie commissions on travel between Australia and the UK to commissions on travel on other routes;
- Computer Reservation Systems (CRSs): Qantas and BA must not be allowed to bias CRS screen displays, including by "screen padding" (displaying their connecting services more than once); and
- Interlining: Qantas and BA must make available to competitor airlines interline fares at their hub airports at rates no less favourable than those they charge each other.

Qantas and BA must also be required to apply for re-authorisation of the JSA well in advance of its expiry date or the period for which re-authorisation is granted must be shortened, in order to prevent Qantas and BA extending the period for which any authorisation is granted, particularly in light of the ACCC's history of granting interim authorisation while they consider applications for re-authorisation.

➢ Finally, Virgin Atlantic would like to address some of the points raised by Qantas and BA over the course of the pre-determination conference. (We will ignore the sillier ones which do not deserve a response):

- Qantas claimed that the JSA has not prevented other airlines entering the Australia-Europe markets. The opposite is the case: as already noted, several European carriers have left the markets. Certainly Virgin Atlantic's entry has been delayed by several years. In addition, even though some entry has occurred, Qantas and BA still enjoy some 60% of the Australia-UK business market, and (according to the ACCC's finding in para. 9.43) economy capacity between Australia and the UK is constrained. That is, over the period the JSA has been in operation the existence of *competitors* has not been sufficient to guarantee *effective competition*;
- Qantas claimed that a 60% market share does not represent dominance. No competition authority in the world would give any credence to such a statement, especially when the remaining 40% is spread among numerous other companies.

For example, in its judgement in *United Brands* (Case 27/76) the European Court of Justice confirmed the European Commission's decision that a firm with a market share in the 40-45% range was dominant where other factors supporting a preponderant position were also present, such as the relationship between the dominant undertaking's market share and shares of its closest competitors. In its *Xth Report on Competition Policy (1980)* the European Commission concluded that: "a dominant position can generally be said to exist once a market share of 40-45% is reached" (point 150);

- Qantas claimed that it could not set fares. All the evidence suggests otherwise, particularly in the case of business fares;
- Qantas claimed that it was increasing business class yields, not fares, by 10% to reflect the introduction of new sleeper seats. Yield, of course, is merely the average of the fares paid by passengers;
- Qantas claimed that the 10% surcharge was intended to account for the extra space that the new Business Class seats occupied. Virgin Atlantic's new Business Class seats, and the sleeper seats they replaced, also necessitated a reduction in the number of seats provided. Yet Virgin Atlantic was not able to increase its fares;

- BA claimed that slots are available at Heathrow for services to Australia. Public statements by BA clearly show this not to be the case. For example, in its submission to the UK Institute of Directors in 2001, *Comments on the IOD's Policy Paper* "Air Warfare", BA said: "Briefly stated, Heathrow as it currently stands is full. The corollaries of this are that... an "open skies" deal with the US can only introduce new carriers or services from Heathrow to the US by displacing other services";
- BA claimed that Virgin Atlantic was simply matching BA and Qantas' own Australia-UK fares. Apart from the fact that Virgin Atlantic has not yet even started services between Sydney and Hong Kong/London, BA and Qantas ignored the special offers Virgin Atlantic has already promoted in the marketplace to both Hong Kong and London;
- BA claimed that most members of its frequent flyer programme were also members of numerous other FFPs. This is undoubtedly true, but wholly irrelevant. The key factor is that passengers tend to use a single FFP in most cases because of the way rewards are structured by airlines. Passengers must accumulate a certain amount of points before any rewards are payable, incentivising passengers to use the services of the dominant carrier (as it is more likely that this carrier will fly to the majority of destinations to which passengers wish to fly, enabling passengers to accumulate points more quickly).

Greater rewards then tend to require the accumulation of (marginally) less and less points, incentivising passengers to concentrate their travel on the dominant carrier. In other words, after accumulating a certain number of points, passengers face "switching costs"- the higher rewards foregone associated with not using the dominant carrier for the same number of points accumulated- when deciding which carrier to use for their next flight. Qantas' FFP is overwhelmingly dominant in the Australian market; BA's FFP is dominant in the UK;

- Finally, BA claimed that CAA *Passenger Survey* data is unreliable. Yet during the European Commission's examination of BA and American Airlines' first application for an exemption from competition laws for their proposed alliance, BA and American recommended that the European Commission use such data to examine the relevant markets: "On the issue of the definition of the relevant markets, BA and AA argued in the course of the administrative proceedings that regard should be had... to the findings of a 1996 CAA study based on statements by a sample of passengers on the reason for their journey..." (see further the European Commission's Draft Decision dated 7 August 1998, at page 32).

- In conclusion, Virgin Atlantic would like to thank the ACCC for the opportunity to present its case orally and to submit these additional comments. We urge the Commission to look again at the analysis contained in its Draft Decision with a view to coming to a different conclusion. In particular, the anti-competitive effect of the Qantas/BA JSA on the all-important business market, and hence the leisure market, must be addressed. The easiest way of doing this, wholly consistent with the approach adopted by other competition authorities in similar circumstances, is to require Qantas and BA to accept the application of certain restrictions on their operations in return for approval of the JSA. It would be totally inappropriate to expect both business and leisure passengers to bear the anti-competitive burden of the JSA in order for leisure passengers to gain, if at all, from the Agreement's claimed cost savings.

Virgin Atlantic Airways

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