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

SUPPLEMENTARY SUBMISSION BY VIRGIN ATLANTIC AIRWAYS

Introduction and Overview

1. Virgin Atlantic appreciates the opportunity to provide a submission in response to the Commission's draft decision to grant authorisation to the Restated Joint Services Agreement (JSA) between Qantas Airways Limited and British Airways Plc (BA).

2. This submission draws on the material presented by Virgin Atlantic at the pre-determination conference held by the Commission on 1 November 2004 in Sydney and responds to certain matters arising out of that conference.

3. In summary, Virgin Atlantic submits that the Commission's analysis, with which it largely agrees, does not support the ultimate conclusion.

   (a) The Commission concludes that the JSA will substantially lessen competition for convenience travel (the business market) particularly to the United Kingdom. However, it is clear that the Commission should also conclude that the JSA will substantially lessen competition in leisure travel (particularly to the UK), given its acknowledgements that i) supply side growth is driven by high yielding passengers and the consequent impact of a lessening of competition in business markets on leisure markets, and ii) the JSA will lead to constraints in the supply of economy capacity between Australia and the UK.

   (b) The Commission itself rejects much of the claimed commercial rationale presented by Qantas and BA for the JSA, that is the claimed inability of end-point carriers to compete with the economies and efficiencies enjoyed by mid-point carriers.

(c) The Commission itself concludes that Qantas and BA cannot quantify the claimed net benefits associated with the JSA and ultimately rejects most of the claimed benefits, yet also concludes that the JSA is likely to lead to cost savings. The Commission appears to believe that these will actually be achieved by Qantas and BA (rather than them choosing an "easy life" and carrying on with the status quo) and be passed onto consumers, in spite of the Commission's acknowledgements regarding the JSA's adverse impacts on competition in the relevant markets described in (a) above.

4. In these circumstances, it is submitted that the Commission's analysis cannot support a conclusion that this matter is "finely balanced".

5. In any event, such a conclusion alone should not be sufficient for the Commission to grant an exemption from the Trade Practices Act to an arrangement involving two substantial and significant competitors coming together to agree on all dimensions of price, service and output.

6. As was held in *QCMA*, it is clearly incumbent on the applicants to satisfy the Commission that there is sufficiently substantial public benefit to outweigh the detriment, especially any anti-competitive detriment, and so justify authorisation.[1] As was stated in that case:

> "Given the value placed upon the promotion and preservation of competition by the Act as a whole, it is a heavy onus"

7. Indeed, it should be questioned as to whether something that is "finely balanced" could ever provide a sufficient basis to warrant granting an exemption from Australia's competition laws.

8. In this submission, Virgin Atlantic will draw on key Commission findings to demonstrate that its analysis does not support authorisation of the JSA.

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1 *Re QCMA* (1976) ATPR ¶40-012 [at 17244].

9. This submission addresses each of the following matters:

   (a) Market definition

   (b) The market dominance of Qantas and BA under the JSA

   (c) The impact of the JSA on competition in business markets

   (d) The impact on leisure markets of a lessening of competition in business markets

   (e) The lack of substantiation of public benefits and rejection of the claimed rationale for the JSA

   (f) The overall weighing of benefits and detriments – "finely balanced"

   (g) Potential conditions

Market Definition

10. The Commission concluded that:

    (a) 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

    (b) the relevant markets are city-pairs, and in this particular case it is not necessary to consider airport-pairs

11. Virgin Atlantic agrees with these conclusions as they are clearly supported by the detailed market analysis set out in the Commission's draft decision.

12. At the pre-determination conference Qantas asserted that evidence of the interrelationship of business and leisure markets supported a conclusion that there is one market. However, the fact that markets are interrelated does not mean that there is one market. Further, supply side substitution was fully considered by the Commission in its draft decision and rejected [8.66 – 8.79].

13. One aspect of the Commission's market definition conclusion which is unclear is the extent to which it is conflating separate outbound and inbound markets. These are distinct markets. The supply of air travel to persons within Australia wishing to depart (and return) is not readily substitutable for air travel for persons outside Australia wishing to come to Australia (and return).

14. As a matter of jurisprudence only the former could relevantly be said to be a market within Australia, as required for the purposes of s 4E.

15. The rolling together of outbound and inbound markets results in the Commission consistently underreporting the true relevant market shares of Qantas and BA, as many more outbound markets are likely to raise competition concerns than inbound markets. This is discussed further below.

The Market Dominance of Qantas and BA Under the JSA

16. The Commission finds that Qantas and BA would together have some 60% of the Australia-UK business market, and almost 70% (68.0%) of the Australia-originating business market [Table 10.7].[2]

17. A market share of greater than 60% is clearly a dominant position and a market share greater than 50% could presumptively be considered to be a dominant one. In fact, the Commission's *Merger Guidelines* adopt 40% as an indicative unilateral market power guide.

18. 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 (Europe's highest court) 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.

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[2] As noted above, the relevant Australian markets for the purposes of s 4E are the outbound markets.

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]

19. The Commission also finds that Qantas and BA would together have business market shares that would ordinarily be considered to be dominant on outbound routes to Singapore (63.3%); Germany (54.5%) and Thailand (45.2%).

20. Nor is the JSA neutral in this respect. It is important to note that, even using a higher threshold for dominance than that used by competition authorities, the JSA actually gives rise to this dominant position in outbound business markets. By way of illustration, in relation to those outbound routes where data is presented by the ACCC [Table 10.7]:

    (a) on the UK route, Qantas is the largest firm with 49.5% and BA the next largest with 18.5%

    (b) on the Singapore route, Qantas is the largest firm with 52.9% and BA the third largest with 10.4%

    (c) on the German route, Qantas is the largest firm with 45.1% and BA the third largest with 9.4%

21. For other destinations the Commission only reports data on a combined outbound and inbound basis. While it is clear that this is likely to underreport outbound market share data by as much as 5-8%, even here Qantas and BA are clearly dominant. For example, France (53.7%), Italy (52.9%), and Spain (61.7%) [Tables 8.3a and 8.3c].

22. In each case the JSA results in Qantas and BA enjoying a dominant position and the removal of the second or third largest competitor to Qantas. In each case, there remains only one other significant competitor, namely Singapore.

23. There is little to distinguish the market concentration/structure in each of the other business markets reported on by the Commission from the UK business market in respect of which the Commission clearly finds there to be a substantial lessening of competition under the JSA. Qantas and BA will similarly dominate these markets, such that there will be a substantial lessening of competition in them under the JSA.

24. As the Commission notes in its draft decision [10.72], the dominant position of the combined Qantas/BA is in itself a significant public detriment:

> "... joint market shares at such levels raise competitive concerns and would be expected... to potentially impact on price, service and product choice"

25. The dangers of a dominant firm are also reflected in the Commission's *Merger Guidelines*:

> "5.88 A merger which increases the level of concentration in a market may reduce competition by increasing the unilateral market power of the merged firm and/or increasing the scope for coordinated conduct among remaining competitors.
>
> 5.89 The unilateral exercise of market power requires that a firm has sufficient control of a market, such that it can profitably 'give less and charge more' without being threatened by competing suppliers. For undifferentiated products this normally requires that a firm controls a substantial portion of capacity. The larger the percentage of total market supply which a firm accounts for, the less severely it must restrict its own output in order to procure a given price increase and the more likely such conduct is to be profitable. For differentiated products, brand loyalty and related factors may further inhibit smaller rivals from successfully preventing the unilateral exercise of market power. Market shares will generally be a good indicator of consumer preferences and brand loyalty for the firms' products; hence the greater the market share of the merged firm, the more potential switching between differentiated products will have been internalised within the firm.

5.90 Firms with unilateral market power can also undertake 'strategic behaviour', such as predation, which may in turn affect market structure and market power. In its consideration of the proposed merger of Bristile and Pioneer's West Australian roof tile operations, the Commission was concerned that the creation of a clear market leader could result in price leadership and/or predation.

5.91 A reduction in the number of firms operating in a market increases the scope for coordinated conduct, including both overt and tacit collusion. It becomes easier to reach agreement on the terms of coordination, to signal intentions to other market participants and to monitor behaviour. More even market shares may increase the commonality of interest between market participants in some circumstances. In other situations the creation of one firm with a large market share may increase the likelihood of price leadership.

5.92 Furthermore, where market structure has been highly concentrated and market shares have been stable for a long period, this will tend to suggest that there are barriers to the entry of new market participants which might otherwise undermine and constrain the exercise of market power."

26. Furthermore, the Commission's market share figures are actually likely to underestimate the competitive position of Qantas and BA in the business market. In markets such as this, a value based share (not a quantity based share) is more likely to provide an appropriate measure of a firm's market power. This is reflected in the Commission's *Merger Guidelines* [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"

27. Virgin Atlantic submits that the Commission should obtain value based measures, otherwise it is likely to significantly underestimate the true market position of Qantas and BA and hence underestimate the effect on competition of the JSA. (This would hold for both business and leisure markets).[3]

28. The value of the market can be easily measured, to a sufficient degree of accuracy, with data from Qantas, BA and a handful of other airlines (as the Commission's market share data discussed above shows, in practice the vast majority of passengers use only a handful of airlines to travel between Australia and the UK). This need only be for outbound traffic (avoiding foreign exchange issues), given this is the relevant market for the purposes of s 4E.

29. The market dominant position of Qantas and BA is supported by substantial barriers to entry and expansion for competing airlines. The one substantial barrier to entry and expansion the Commission readily acknowledges is slot constraints at Heathrow and the importance of operating to and from Heathrow on the UK route.

30. A measure of the extent of this barrier to entry is reflected in the prices paid recently by airlines, including Qantas and BA, for slots at Heathrow. The Commission finds that:

> "There can be no clearer evidence of this constraint than the preparedness of Qantas to pay nearly 20 million pounds in January 2004 for slots enabling two additional return flights per day" [10.67]

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3 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.

31. The price paid by Qantas represents twice the amount per slot that Virgin Atlantic paid at that time for four daily slot pairs. Qantas could only do this because it is able to pass on the additional cost in the "cost-plus" JSA environment in which it operates.

32. At the pre-determination conference, Qantas claimed that the reason it paid this price is because of the high cost of operating from two airports in the one city. However, it has provided no evidence that this "dual" operating cost, which would have to be incredibly high, justified expanding services at Heathrow at a cost of £20 million. More generally, Qantas' claim conflicts with the numerous findings of competition authorities in recent years in relation to the importance of Heathrow, cited in Virgin Atlantic's original submission [pp 7-10].

33. BA claimed that slots are readily 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"

34. In its draft decision, the Commission refers to certain other barriers to entry, such as Frequent Flyer Programmes (FFPs) and feeder traffic [10.39ff], but generally fails to fully consider these factors as it concludes they are not altered by the JSA. However, the fact there are such barriers is important in and of itself as such barriers are likely to exacerbate the anti-competitive detriment of the JSA. In addition, to the extent that such barriers can be reduced through conditions, then the anti-competitive effect of the JSA can be ameliorated.

35. Furthermore, the JSA gives Qantas and BA the opportunity to make these barriers to entry even higher. In the case of loyalty programmes such as corporate deals, FFPs and incentive schemes for travel agents, this is because of the way rewards are structured under these schemes. Firms, passengers and travel agents must direct a certain amount of their business to an airline before any rewards are payable, incentivising them 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 firms wish their employees to fly/ passengers wish to fly, enabling reward qualifying levels to be met more quickly).

36. Greater rewards then tend to require the direction of (marginally) less and less business, incentivising firms, passengers and travel agents to direct their business to the dominant carrier. In other words, after directing a certain amount of their business, firms, passengers and travel agents face "switching costs"- the higher rewards foregone associated with not using the dominant carrier for the same business directed- when deciding which carrier to direct their business to. Enabling firms to count employee travel/ passengers to count travel/ travel agents to count travel booked on the other's flights towards reward qualifying levels therefore allows each of Qantas and BA to increase the switching costs associated with their loyalty programmes, and hence increases barriers to entry.

37. The effect that the way rewards are structured under loyalty programmes has on firm, passenger and travel agent loyalty to the dominant airline shows that BA's comment at the pre-determination conference that most members of its FFP were also members of numerous other FFPs, while undoubtedly true, is wholly irrelevant. Qantas' FFP is overwhelmingly dominant in the Australian market; BA's FFP is dominant in the UK.

The Impact of the JSA on Competition in Business Markets

38. The Commission finds clear evidence of existing and potential future substantial losses to consumers from the absence of significant competition in business markets arising from the JSA, particularly on the UK route. For example, the Commission's analysis demonstrates:

    (a) a reduction in service quality and output, including evidence that:

    - Qantas has delayed its introduction of Business Class sleeper seats. In the business market product is a key competitive tool. Virgin Atlantic is about to complete the second product cycle of such seats, having initially introduced them several years ago. It is evident that unlike most other major airlines, Qantas does not feel under any significant competitive pressure in the business market
    - Qantas has reduced services to Paris and Rome
    - load factors on the UK route are already "very high" [9.41]
    - passengers have been "spilled" on JSA services due to high load factors [9.41]
    - capacity growth on the UK route under the JSA will be significantly lower than market growth [9.38-9.41]
    - passenger access to the UK route will become increasingly difficult over the next five years, given the significant contribution in capacity terms Qantas and BA make to this route and the barriers to entry facing other airlines wanting to expand their services to/from Heathrow [9.43]

(b) a "cost-plus" approach to competition/ an increase in prices:

- 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 Commission 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. In this context, it is noted that at the pre-determination conference, Qantas claimed that it was increasing business class yields, not fares, by 10% to reflect the introduction of new 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

- premium cabin fares have risen substantially under the JSA [11.30]

- fares for many business travellers are likely to increase under the JSA [11.30]

(c) increasing barriers to entry and expansion for other airlines:

- while Qantas claimed during the pre-determination conference that the JSA has not prevented other airlines entering Australia-Europe markets, the opposite is the case, with the JSA coinciding with the departure of several European carriers

- the JSA has contributed significantly to the delay in Virgin Atlantic entering the Australia-UK markets. Certainly Virgin Atlantic's entry has been delayed by several years

- even though some entry has occurred, Qantas and BA still enjoy some 70% of the Australia outbound business market on the UK route and market shares of greater than 50% and 60% on other routes. That is, the existence of competitors has not been sufficient to bring about effective competition over the period the JSA has been in operation

39. In short, the Commission's analysis supports a conclusion that the JSA has very detrimental effects on competition in business markets.

The Impact on Leisure Markets of a Lessening of Competition in Business Markets

40. While the Commission's ultimate conclusion with regard to leisure markets is that there is no lessening of competition in these markets, its analysis actually points strongly to the opposite conclusion. For example, the Commission finds that:

    (a) higher yielding passengers such as business passengers contribute disproportionately to the overall revenue of the carrier [10.76]

    (b) airlines' supply of services (to both high yielding and economy passengers) is correlated closely to demand from high yielding passengers rather than economy passengers [9.44], and hence outcomes in business markets will affect outcomes in leisure markets

    (c) Qantas has reduced services to Paris and Rome

    (d) load factors on the UK route are already "very high" [9.41]

    (e) passengers have been "spilled" on JSA services due to high load factors [9.41]

    (f) capacity growth on the UK route under the JSA will be significantly lower than market growth [9.38-9.41]

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[4] 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.

(g) the JSA will lead to constraints in the supply of economy capacity between Australia and the UK [9.43]

(h) passenger access will become increasingly difficult over the next five years, given the significant contribution in capacity terms Qantas and BA make to this route and the barriers to entry facing other airlines wanting to expand their services to/from Heathrow [9.43]

(i) fares will not reduce under the JSA in the short to medium term [11.32]

(j) the JSA has coincided with the departure of several European carriers

(k) the JSA has contributed significantly to the delay in Virgin Atlantic entering the Australia-UK markets

(l) (a)-(k) have occurred/ will occur even though some entry has occurred. That is, the existence of competitors has not been sufficient to bring about effective competition over the period the JSA has been in operation

41. The adverse effects on leisure markets flow directly from the anti-competitive effects of the JSA on business markets identified above, namely:

(a) a reduction in service quality and output

(b) an increase in prices

(c) increasing barriers to entry and expansion for other airlines

42. The Commission's analysis indicates that the business market is extremely important for airlines. The Commission notes that business travel accounts for between 10.5% and 16.3% of passengers travelling on routes between Australia and the UK.

43. These figures considerably underestimate the true importance of the business market. As the slides presented by Virgin Atlantic at its meeting with the Commission of 10 June 2004 and at the pre-determination conference of 1 November 2004, reproduced here as Figures 1 and 2, show, higher yielding passengers such as business passengers not only represent a greater proportion of airlines' revenue than passenger numbers, but also drive airlines' route entry and expansion decisions.

Figure 1

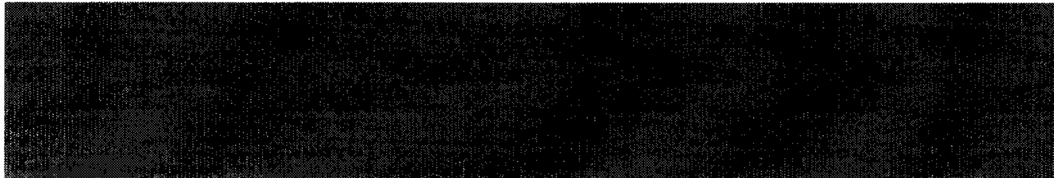
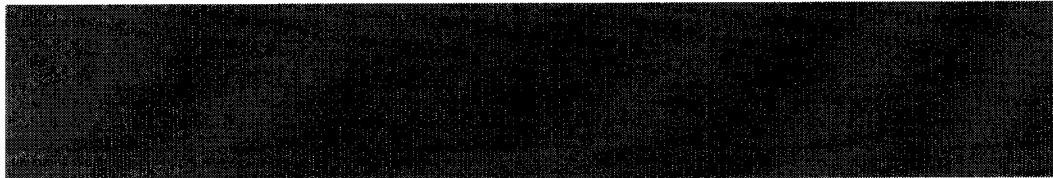


Figure 2



	£'000s
Upper Class Net Revenue	(redacted)
Upper Passenger Direct Operating Costs	(redacted)
Upper Class Contribution	(redacted)
Premium Economy Class Net Revenue	(redacted)
Premium Passenger Direct Operating Costs	(redacted)
Premium Economy Class Contribution	(redacted)
Economy Class Net Revenue	(redacted)
Economy Passenger Direct Operating Costs	(redacted)
Economy Class Contribution	(redacted)
Inflight Sales	(redacted)
Incidentals	(redacted)
TSC	(redacted)
PSC	(redacted)
Total Passenger Contribution	(redacted)
Freight Contribution	(redacted)
Total Passenger and Freight Contribution	(redacted)
Rotation Fuel	(redacted)
Sector Direct Operating Costs	(redacted)
Flight Hour Costs	(redacted)
Reprotection and Subcharters	(redacted)
Total Sector Direct Operating Costs	(redacted)
Aircraft Standing Charges	(redacted)
Crew Costs	(redacted)
Total Fixed Operating Costs	(redacted)

Note: Total Fixed Operating Costs does not yet take account of overhead costs

44. The importance of the business market is also 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 commercially viable if the airlines concerned had to rely solely or mainly on leisure passengers.

45. To this extent, what happens in the business market affects what happens in the leisure market (but not vice-versa). The Commission's analysis in its draft decision strongly reflects 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" [9.44]

46. Given that, in light of the nature of supply, what happens in business markets affects outcomes in leisure markets, Qantas and BA's dominance of Australia-UK business markets will affect Australia-UK leisure market outcomes. Indeed, the Commission finds evidence of this in the analysis contained in its draft decision:

> "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" [9.43]

47. However, this finding is not reflected in the Commission's ultimate conclusions on Australia-UK leisure markets. On page iii the Commission states:

> "the United Kingdom business passenger market is the only market where the lessening of competition currently seems likely to be substantial"

48. The Commission therefore goes on to conclude that there is a "fine balance" between competitive detriment and public benefit from the JSA. With respect, this fine balance would not exist if the real implications of the JSA for leisure markets were recognised.

49. Virgin Atlantic has chosen to enter the Australia-UK markets at this time principally 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.[5]

50. Virgin Atlantic is extremely concerned about the potential anti-competitive impact of the JSA on its new service between Sydney and London. In particular, Qantas and BA's dominance in the Australia-UK business markets will put them in an incredibly strong position to impede the entry and expansion of competitors, affecting adversely both Australia-UK business and leisure market outcomes.

51. BA also has a history of anti-competitive activity. It sought to prevent Virgin Atlantic's early expansion by acting illegally (behaviour which came to be known as the "dirty tricks" campaign against Virgin Atlantic). Since then it has been found guilty of illegal activity in the UK market for air 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 (OFT) for alleged anti-competitive behaviour in the market for corporate sales. The OFT has concluded that BA has a *prima facie* case to answer.

52. There must similarly be a real risk that Qantas will react to Virgin Atlantic's entry to the Australia-UK markets by resorting to actions which will impede Virgin Atlantic's competitive operation. 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.

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5 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.

Lack of Substantiation of Public Benefits and Rejection of the Claimed Rationale for the JSA

53. The Qantas/BA case for authorisation really rests on some simple arguments:

    (a) that mid point carriers have substantial logistical and cost advantages over end point carriers

    (b) these advantages have led to most European end point carriers exiting the market

    (c) the JSA allows Qantas and BA to maintain passenger levels on both sides of their Singapore hub and offsets the logistical and to some extent the cost advantages of mid point carriers

    (d) cost savings and efficiencies have been passed through to passengers under the JSA leading to a reduction in fare levels and increased capacity

    (e) without the JSA, Qantas and BA would reduce services and would not code share

54. While proposing to grant authorisation, the Commission's analysis largely refutes each of the above points. The Commission:

    (a) does not accept that Qantas and BA are actually materially disadvantaged in relation to mid point carriers and identifies a number of substantial cost and logistical advantages available to Qantas and BA [9.92 and following]

    (b) does not accept that the JSA has actually resulted in a reduction in fares [11.24-32 and 11.106] or increase in capacity compared to what would otherwise be expected [11.107]

    (c) identifies a number of reasons as to why there is unlikely to be a material reduction in services by Qantas and BA compared to the position under the JSA [9.106 and following]

55. In short, there is actually very little support for the claimed commercial rationale for the JSA in the Commission's analysis. In these circumstances, it is perhaps not surprising that the Commission also rejects most of the benefit arguments.

56. The Commission rejects most of Qantas and BA's public benefit arguments, accepting only claims in relation to some cost reduction and enhanced service provision. Even in this regard, the Commission does not appear to be convinced that there is likely to be a major enhancement in service provision or cost reduction compared to the position without the JSA.

57. Furthermore, the Commission does not actually appear to have satisfied itself that there are any cost savings. Rather, it tellingly observes that:

> "... it would be surprising if two substantial businesses such as Qantas and BA were not able to achieve substantial cost savings through a joint rationalisation of aircraft operations and support services. No material presented to the Commission provides a basis for the Commission to resile from that position" [11.13]

58. In short, it would appear that the Commission presumptively concludes that there are such savings, without being satisfied on the evidence. This is clearly an impermissible basis on which to grant authorisation. As the Tribunal in *Re QCMA* [at 17244] noted:

> "It is not sufficient for an applicant to point to a clear public benefit and then leave it to others to try to show that, nevertheless, the authorisation would not be justified"

59. The only analysis of the evidence of cost savings [11.14] makes it clear that the Commission has rejected the attribution of cost savings to the JSA. In short, a reading of the Commission's analysis does not provide any support for a conclusion that there are likely to be cost savings.

The Overall Weighing of Benefits and Detriments – "Finely Balanced"

60. The Commission ultimately concludes that there are benefits (by way of cost savings) that are likely to be passed on to leisure passengers, but disbenefits to business passengers. Overall, the Commission concludes that there are marginally more benefits than detriments and indicates therefore that it is minded to approve the JSA.

61. A finding that the matter is "finely balanced" suggests a degree of precision in the weighing of benefits and detriments that belies any real capacity to quantitatively assess the claimed benefits or likely detriments.

62. The Act requires that the Commission be positively satisfied that the benefits outweigh the detriments. If the matter is finely balanced, then that is a virtual recognition that the Commission is not so satisfied. For the Commission to be positively satisfied that the benefits outweigh the detriments on a finely balanced basis, it would need to have a degree of precision in measuring the benefits and detriments that was sufficiently precise to avoid any "measurement error".

63. By way of simple illustration, if benefits were 100, detriments 95, and the measurement error less than 5, then it may be appropriate to authorise on a finely balanced basis.

64. However, if the measurement error was greater than 5, then finely balanced means little more than tossing a coin: it could go either way. This is clearly not a sufficient basis to grant statutory exemption to an arrangement involving two substantial and significant competitors coming together to agree on all dimensions of price, service and output.

65. In substance it appears that the phrase "finely balanced" is little more than a way of expressing the position that the Commission finds it hard to form a clear conclusion either way, i.e. it is a coin toss. Such a conclusion alone should be sufficient for the Commission to refuse to grant an exemption from the Trade Practices Act.

66. As was held in *QCMA*, it is clearly incumbent on the applicants to satisfy the Commission that there are sufficiently substantial public benefits to outweigh the detriment, especially any anti-competitive detriment, and so justify authorisation.[6] As was stated in that case:

> "Given the value placed upon the promotion and preservation of competition by the Act as a whole, it is a heavy onus"

67. In *Re MGICA Ltd and AMIC Ltd* (1984) ATPR ¶40-494 the Tribunal found itself:

> "in a position where it has no material before it which could positively satisfy it that in all the circumstances the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed conduct should be allowed to take place"

The Tribunal considered that in these circumstances it was bound to determine that the Commission's determination granting authorisation to the proposed conduct be set aside.

68. The Commission's *Guidelines on Authorising Anti-Competitive Conduct* also state [p4] that the onus is on the applicant to demonstrate to the Commission the public benefit arising from the conduct and that this benefit outweighs any detriment, including any substantial lessening of competition.

69. Ultimately, it is highly doubtful whether something that is "finely balanced" could ever provide a sufficient basis to warrant granting an exemption from Australia's competition laws.

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[6] *Re QCMA* [at 17244].

Potential Conditions

70. In circumstances where the Commission recognises the presence of some benefits, but in practice cannot readily assess whether these outweigh or are outweighed by the anti-competitive detriments, the Commission need not be left in the position of tossing a coin.

71. A better approach is to keep the perceived benefits while at the same time seeking to remove the detriments. This is consistent with Australian authority. For example, in *Re Rural Traders Co-operative (WA) Ltd* (1979) 37 FLR 244, the Tribunal was asked to review a merger authorisation granted by the Commission. In relation to the relative weight of the benefits and detriments, the Tribunal said [at 288]:

> "... we consider the detriments to the public constituted by the likely effects of the proposed acquisitions upon competition in the fertilizer distribution market and in the stock and station agents' services market to be real and of significance. Plainly, the matter is a marginal one involving elements of subjective assessment which could legitimately lead to differences of opinion"

72. The Tribunal then proceeded to authorise the merger subject to certain conditions which it felt would ensure that the merger could result in "such a public benefit that they [the proposed acquisition of shares] should be allowed to take place."

73. Removal of detriments 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).

74. 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*.

75. In this regard, Virgin Atlantic's ability to compete effectively in the Australia-UK markets is critically dependent on there being competition on the merits, devoid of the exercise of substantial market power. 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 Commission before, not after, other airlines are forced out of the markets or are constrained to an insignificant position.

76. This is why Virgin Atlantic is proposing that certain restrictions should be imposed on Qantas and BA with respect to the business market in particular 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.

77. Virgin Atlantic urges the Commission 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)

- 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)

- 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

78. 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 Commission's history of granting interim authorisation while applications for re-authorisation are considered.

Conclusion

79. In conclusion, Virgin Atlantic would like to thank the Commission 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 on to leisure markets 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

18 November 2004