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Applications for Authorisation A30226 and A30227

Submission to ACCC regarding Draft Determination dated 23 August 2004

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and

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SUBMISSION TO ACCC REGARDING DRAFT DETERMINATION

12 November 2004

INTRODUCTION

On 23 August 2004 the Australian Competition and Consumer Commission (the **Commission**) issued a draft determination proposing to grant authorisation for a period of five years in relation to the Restated Joint Services Agreement (**JSA**) between Qantas Airways Limited (**Qantas**) and British Airways Plc (**British Airways**) (the **Draft Determination**). Qantas and British Airways support the Commission's Draft Determination.

The JSA has been in operation for over eight years. Over this period the level of competition has intensified – for example:

1. the total market has grown by over 40% - this is notwithstanding external shocks to the industry which have impacted demand such as terrorism, the conflict in Iraq and SARS;
2. new competitors have entered the market and many existing carriers have continued to expand. Mid point carriers (such as Singapore Airlines, Cathay Pacific, Emirates, Malaysia Airlines, JAL and Thai Airways) are permanent competitors who are committed to the Australian market as a critical part of their hub and spoke network;
3. economy fares have decreased in real terms by over 25% whilst service and product standards have increased; and
4. at the same time, the combined market share of Qantas and British Airways has declined.

The JSA has delivered the following real tangible benefits to the Australian public:

1. joint inventory management has maximised the availability of lowest possible fares;
2. Qantas customers in Europe are provided with better access to British Airways' inventory than would be available under the **one**world alliance;
3. real cost reductions (joint IT development, joint sales and joint offices) have been achieved and have been (and continue to be) passed on to consumers;
4. consumers have greater schedule choice and flexibility;
5. the enhanced ability of Qantas and British Airways to economically service a range of destinations and frequencies relative to the alternative (where each would have been operating alone); and
6. increased services to and from Australia have encouraged more tourism whilst more Qantas operated services has meant more Australian employment and greater net exports.

Given these facts and the large volume of uncontested evidence provided to the Commission, the parties believe that there are substantial benefits associated with the JSA, which clearly outweigh what must be, on any view, minimal (or no) competitive detriment.

This Submission sets out more information on those areas of the Draft Determination where the Applicants believe greater clarity is required prior to the Commission finalising its Determination and addresses certain matters raised in the Commission's pre-determination conference on 1 November 2004.

1. MARKET DEFINITION

At paragraph 8.77 of the Draft Determination the Commission concludes "there are separate markets for business and leisure travellers on long haul routes". This conclusion appears to primarily arise from the Commission's view that business travellers are first and foremost concerned with "comfort, travel time and flexibility in making and changing travel arrangements", rather than with price. In contrast, leisure travellers are primarily price driven. Furthermore, for business travellers the Commission has adopted a city pair or "point to point" geographic market definition (paragraphs 8.90 and 8.99).

The Applicants do not support the Commission's conclusions. As explained in earlier submissions[1], the Applicants believe that the appropriate market for analysis in the case of the JSA routes is a regional market for flights between Australia and Europe for all passengers. The Applicants also submit that the Commission's approach to market definition contains a number of inconsistencies, for reasons set out more fully below.

Customer Market Issues: Premium v. Economy Cabins

In paragraph 8.77 the Commission has distinguished business travellers on long haul routes as being primarily concerned with **comfort**. This suggests that the markets are split based on cabin-type (premium versus economy class). For example, at paragraph 8.59:

> *"...(t)he Commission believes that in recognition of the comfort factor on long haul and given that business travellers are not personally incurring expenditure, they would be averse to moving down in fare class even if those fares are considerably lower and travel flexibility could be achieved at lower levels."*

The Applicants do not agree there are separate markets for premium and economy cabins. There are a number of demand side factors that make a cabin based market distinction inappropriate on JSA routes. These factors include[2]:

1. JSA routes are predominantly leisure routes, with only a small percentage of travellers using the routes for business purposes. Australian Bureau of Statistics data shows that only in the order of 12.8% of travellers between Australia and Europe are travelling for business purposes. Additionally, the characteristics of the Australia-Europe market mean that a high proportion of this small group of travellers fly in the economy cabin and make use of heavily discounted fare types.

2. JSA routes are extremely long haul in nature. Indeed, the Kangaroo Route is amongst the longest commercially operated routes in the world. The nature of very long haul routes means flights take all day and night and are not staggered throughout the day. As a result, passengers commonly plan such trips a significant time in advance and stay at their destination for some time. These factors make it possible for a high proportion of business travellers on JSA routes to consider fare types (and cabins) that might traditionally be associated with leisure travel.

3. Business travellers (or more accurately businesses) are increasingly under pressure to minimise costs and are, therefore, increasingly price sensitive. Corporations are now demonstrably cost conscious when purchasing travel and will consider switching employees from premium to economy cabins in

[1] See, for example, the parties' letter to the Commission dated 12 March 2004.
[2] See confidential Attachment 1 (Response to Virgin Atlantic submission dated 3 November 2003) to the parties' letter to the Commission dated 12 December 2003 (pp.5 – 9).

response to absolute or relative movements in travel costs. This is reflected in the fact that both 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 and that a significant number of leisure passengers fly in the premium cabins.

These factors mean the line between those who book tickets in premium classes and those who book restricted tickets in economy class (traditionally classed as "leisure" travellers) has blurred, replaced instead with a broad variety of substitution possibilities across the full range of fare types. In light of the high degree of demand side substitutability between fare classes on Australia – Europe routes, it is inaccurate to use the premium cabins as a proxy for passengers travelling with a business purpose. Such a high degree of substitutability also argues in favour of a single market definition.

Customer Market Issues: Flexible v. Non-flexible Travellers

At paragraph 8.77 of the Draft Determination the Commission seems to suggest that the business traveller market should also be defined by those passengers that are concerned with "**travel time**" and "**flexibility in making and changing travel arrangements**". Qantas and British Airways do not agree there is a separate business market defined by time-sensitive travellers and travellers requiring flexibility, on JSA routes. These conclusions are inconsistent with certain key demand side factors already outlined above. In particular, the parties note[3]:

1. Given the physical distances involved on routes between Europe and Australia, all passengers are required to travel for at least 24 hours and to make at least one stopover mid point. As such, any distinction between direct and indirect routes based on time sensitivity is less relevant compared with shorter haul non-stop routes. As a result, the Applicants submit that the terminology of "time-sensitive passengers" is not appropriate in the context of the JSA.

2. As the JSA routes are extremely long haul in nature, business passengers (who may be more time sensitive) or passengers concerned with flexibility commonly plan such trips a significant time in advance and stay at their destination for some time, making it possible to use less flexible fare classes that might traditionally have been associated with leisure travellers.

3. Corporate employers are increasingly price sensitive. As mentioned above, this is reflected in the fact that both 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. Similarly, British Airways' research shows that in 2003, only around 40% of passengers travelling in its premium cabins from the United Kingdom to Australia were travelling for business purposes.

The relevant issue to address when considering demand side substitutability and market definition is the willingness of passengers to switch carrier or type of ticket or downgrade their cabin, rather than accept a price increase. In this instance, business passengers who are time sensitive or who require flexibility (and therefore would generally purchase unrestricted or premium cabin fares) have a wide array of alternatives available in the face of a hypothetical increase in fares by any carrier or alliance. There include substituting other carriers' services, downgrading in service class on the same aircraft or switching to more restricted fares. There is no material

[3] See n.2.

before the Commission to suggest passengers will be insensitive to a price increase on the very competitive JSA routes.

Customer Market Issues: Business v. Convention Travellers

In paragraph 10.11 of the Draft Determination, the Commission notes it is going to regard as business travellers those travelling for the purpose of business and conventions. Qantas and British Airways consider this consolidation inappropriate. In this regard, we note the approach adopted by the Commission in its authorisation of the Star Alliance "Guidelines for the Conventions Plus Program" in September 2003. At paragraph 7.45 of that authorisation the Commission noted "there would appear to be a distinction between the demand characteristics of convention delegates and business travellers". In particular:

1. Convention delegates have considerable advance notice of their overseas travel requirements whereas business travellers are likely to need to travel at short notice.

2. Convention delegates are able to purchase advance APEX fares, which enable overseas travel at a discounted price relative to full fare.

3. Business travellers are more likely to travel in premium cabins than convention delegates.

4. Convention delegates appear to have many of the same characteristics of leisure rather than business passengers.

Geographic Market Issues: City Pair v. Regional

The Draft Determination concludes that a regional approach to geographic markets on the JSA routes still appears appropriate for leisure passengers. However, for business travellers (however defined) the Commission has adopted a city pair or "point to point" geographic market definition (paragraphs 8.90 and 8.99).

Qantas and British Airways do not agree that business passengers flying on JSA services operate in city pair markets and note the following in support of their position[4]:

1. The extreme long haul nature of flights between Australia and Europe means that a high proportion of both business and leisure travellers take the opportunity to visit multiple cities in Europe or Australia. As a result, a high proportion of travellers will regard flights to a number of cities within Europe as highly substitutable.

2. A high proportion of passengers from Australia to Europe do not fly direct to their ultimate destination. Instead, they use a two-stop service, flying initially (via a midpoint) into a hub in Europe (such as Heathrow) and transferring (either immediately or after a stop over) at this hub to a connecting flight to their ultimate destination. Passengers are likely to regard initial flights into or out of any hub in Europe that is close to their final destination as substitutable.

3. The conduct being analysed by the Commission consists of coordination by two carriers in relation to a bundle of interdependent routes between Australia and all of Europe. In this context, the parties consider a purposive approach to market definition would favour a regional geographic market definition.

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[4] See n.2 at pp. 2 – 3. See also section 4.2 (Geographic Markets) of the NECG Report dated May 2003 at pp.43 – 51.

The factors above point to a conclusion that the market for all flights to the UK and Europe (whether business or leisure) is regional in nature and there is a high degree of substitutability between flights within that region. This is also evidenced by the fact that airlines generally common rate their fares from Australia to all destinations in Europe.

Product Market Issues: Supply-Side Considerations

The Applicants submit the difficulties displayed by the Commission in identifying the appropriate product market boundaries highlights the practical blurring of the line between different passenger types and the range of available substitution possibilities amongst fare classes. This supports the Applicants' view that a single market definition is more appropriate for the JSA routes. Additional support for this approach can also be drawn from supply side analysis, which remains an important component of market definition.

First, airlines ensure that there is almost perfect supply side substitutability between different fare classes through their use of yield management and inventory systems.

Second, there are significant economies of scope associated with servicing a wide range of customers with different demand profiles. As a matter of commercial reality, this greatly strengthens the incentives airlines have to compete across customer segments (ie business and leisure travellers).[5] Indeed, at the Commission's pre-determination conference on 1 November 2004, Virgin Atlantic repeatedly articulated its view that business and leisure passengers are inextricably linked on the supply side. That is, the inclusion of business passengers and a premium cabin product are essential to providing a service on the long haul JSA routes.

The Applicants accept Virgin Atlantic's acknowledgment of the importance of business passengers to long haul routes such as those serviced by the JSA. In the course of the pre-determination conference, Virgin Atlantic went on to submit that "if it were not for the business market on the Kangaroo Route, British Airways, Qantas and Virgin Atlantic would be unlikely to operate as markets would not be viable".[6] The proper definition of the market is therefore one that encompasses both types of travellers.

2. COST OF CAPITAL

The Commission focuses on Qantas' financial performance based on the results reported in its annual reports (Table 4.8 at paragraph 4.29). From these results the Commission has concluded: "Qantas has continued to achieve profitability at a time when the industry globally has been sustaining losses" (paragraph 4.29). Whilst Qantas is proud of its success to date in maintaining revenue while extracting cost reductions and efficiencies, it is acutely aware of the cyclical nature of the industry, the industry's susceptibility to major exogenous shocks and the need to recover its cost of capital.

The aviation industry is highly capital intensive. Qantas (as well as other airlines) has on-going financial obligations in relation to re-investment and is not currently meeting its cost of capital. For this reason, short-term profitability cannot be assumed to guarantee long term viability.

[5] See n.2. See also Attachment 3 to the parties' letter to the Commission dated 7 August 2003 (at pp.1 – 2).
[6] Commission record of pre-determination conference, 1 November 2004 at p.4.

3. COUNTERFACTUAL

Equity Relationship

In its Draft Determination, the Commission implied that British Airways' shareholding in Qantas was inconsistent with British Airways' submission that it would not allow Qantas to code share on British Airways' services to Europe absent the JSA (that is, under the counterfactual advanced by the parties): paragraph 9.130 of the Draft Determination.

On 9 September 2004, after the Commission published its Draft Determination, British Airways sold its 18.25% shareholding, ending the 11 year equity relationship between the companies. The sale of British Airways' shareholding in Qantas will not affect the operation of the JSA or validity of the Applicants' submissions.

As noted in previous submissions, absent the JSA, British Airways would seek to maximise its own traffic across its own network as a first priority, rather than entering into a code share agreement with Qantas. There is now no equity-related rationale for it to provide any commercial preference to Qantas in the counterfactual scenario.

Volume Forecasts

The Commission perceived an inconsistency between the Applicants' current healthy demand forecasts for traffic on the Kangaroo Route, and the counterfactual which would see both Qantas and British Airways reducing capacity absent the JSA: paragraphs 9.51, 9.88 - 9.91 of the Draft Determination.[7]

The Applicants' submit that there are not any inconsistencies between the current and counterfactual forecasts. It is the Applicants' submission that:

1. Without the ability to co-ordinate price and schedules under the JSA, the range of destinations and schedule flexibility (seat availability through joint yield management) offered by British Airways and Qantas would be more limited, despite strong demand on the Kangaroo Route.

2. When airlines make decisions regarding the allocation of capacity, they will have regard to real average yields on a route. It is incorrect to use high levels of customer demand as a guide to yield performance. The two do not necessarily equate.

3. The particular economics of end point carriers on the Kangaroo Route mean that without the JSA it would be much more difficult to economically service the current number of destinations and frequencies presently offered to the public. Even if strong demand persisted on the route, the increased cost of having to service all of the current JSA destinations would not be recoverable by either carrier under the counterfactual, where each would be operating alone.

In addition, Qantas and British Airways note that the counterfactual proposed by the Applicants was prepared in late 2002 and early 2003. As the Commission acknowledges[8], during this time the industry was experiencing extreme uncertainty and a number of exogenous shocks such as the potential threat of war in Iraq and SARS, which was particularly potent given the importance to the Applicants of mid points in Asia.

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[7] This criticism was also raised by Virgin Atlantic at the pre-determination conference, where it called the credibility of the Applicants into question.

[8] Draft Determination, paragraph 4.29.

Against this background, both Qantas and British Airways constantly monitor their respective performance on the Kangaroo Route. The JSA has assisted the parties to - maintain the depth and breadth of their network in the face of intensifying competition and a time of volatility in the aviation sector. Even though the increase in competition has led to contractions on sectors where the parties' cannot operate at least on a break even basis, such as Qantas' withdrawal of services to Rome and Paris, it is highly likely that further contractions would occur without the JSA for the reasons outlined above.

Alliances

Both British Airways and Qantas are members of the **one**world alliance. **one**world provides for limited co-ordination between the member airlines and should be distinguished from other airline alliances, such as the Star Alliance, in which carriers are better able, should they choose and as a result of numerous anti-trust immunities between the members, to act as a single integrated airline.

As the Commission recognises[9], membership of a marketing alliance, such as the **one**world alliance, is not a prerequisite for code share arrangements between airlines. The Applicants contend that their membership of the **one**world alliance does not, of itself, make code share arrangements between them more likely, absent the JSA.

4. DETRIMENT

In paragraphs 10.103 - 10.104 of the Draft Determination, the Commission asserts that the JSA could lessen competition in all international passenger markets where both airlines have an operational presence, although ".. the UK business passenger market is the only market where the lessening of competition seems substantial"[10].

This section of the Applicants' response deals specifically with the Commission's contentions that, firstly, the JSA could give rise to a substantial lessening of competition in the UK-Australia business passenger market, and secondly, that slot constraints at Heathrow Airport have given rise to high barriers to entry and expansion in this market (howsoever defined).

4.1 UK-Australia Business Passenger Market

The Applicants disagree with the Commission's view that the JSA could result in a substantial lessening of competition in the market for business travel between Australia and the UK.

Even if the Applicants were to accept that this is the relevant market for assessing the impact of the JSA (which, as discussed in section 1 above, the Applicants do not accept), the Applicants believe that this market is in fact highly competitive, being characterised by:

1. declining market share for the Applicants over the life of the JSA. On the basis of ABS data, the Applicants' combined market share for both business and leisure passengers on routes between Europe and Australia has declined in a growing market;

2. a range of alternative service providers all of whom compete vigorously with each other for all passengers, particularly with respect to product offering and service levels;

[9] Draft Determination, paragraph 9.110.

[10] Draft Determination, paragraph 10.104

3. passengers who are increasingly price sensitive[11]; and

4. entry and expansion of new and existing competitors.

The reasons for these views are set out below.

Price sensitivity of business passengers

The Applicants submit that the view that certain business travellers are relatively price insensitive is not correct, as outlined in section 1.

Given that there is evidence that business passengers are price sensitive and increasingly cost conscious, if British Airways and Qantas were to attempt to raise prices for business passengers above competitive levels, it is likely that a proportion of "marginal" business passengers would switch to an alternative airline providing a comparable product offering at a better price (as may be required by an employer's "best fare of the day" policy)[12]. Given that the loss of only a few passengers to a competitor airline can make a price increase unprofitable, the Applicants consider that other airlines (which collectively account for nearly 40% of the "UK market for business passengers"[13]) are able to, and do, exert a substantial constraint on the pricing conduct of British Airways and Qantas for premium passengers. The constraint is sufficiently large to prevent British Airways and Qantas from having the ability to substantially lessen competition for premium passengers travelling between the United Kingdom and Australia.

This submission finds support in a slide entitled "Importance of time-sensitive travellers" in the Virgin Atlantic presentation to the Commission on 10 June 2004. Though masked for confidentiality, it appears clear that for Virgin Atlantic premium cabin travellers represent a small percentage of passengers but a high percentage of revenue. Most pertinently, the slide goes on to say: "As a result, profitability is very sensitive to Upper Class loads".

The Applicants also note Virgin Atlantic's submission at the pre-determination conference that it was not aware of any competition regulator that would not consider a 60% market share as anything but indicative of market dominance. By way of response, the Applicants submit it is well established, both in Australian and foreign jurisprudence, that market concentration is merely one of a number of factors to be considered in competition analysis and the determination of market power. Indeed, the most critical considerations are the conditions and height of any barriers to entry and expansion[14]. In the case of JSA routes, there is overwhelming evidence that barriers to entry and expansion are low to non-existent.

Product Competition

As the Commission will be aware, routes between the UK and Australia are amongst the longest commercially operated routes in the world. As such, quality of service and comfort on board are factors that can influence a passenger's choice of airline.

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[11] See KLM/Air France European merger decision at paragraph 22: "...., *on long haul routes, the dividing line between time sensitive and non time sensitive passengers has become less clear. As was reported by several parties (including the merging parties themselves), an increasing number of time-sensitive passengers appear to have become price sensitive. In particular, an increasing number of undertakings require their employees to take the most economical flights, including indirect flights, irrespective of total flight duration or longer connecting times. It is therefore still considered that the availability of flights with a maximum connection time of 150 minutes exert sufficient competitive constraints on long haul direct flights*".

[12] Such "marginal" passengers would also be likely to down-grade their cabin class than pay a higher fare.

[13] See Table 10.7 in the Draft Determination

[14] By way of example, see *Re Queensland Co-operative Milling Association Limited* (1976) 25 FLR 169.

For passengers travelling in a premium cabin (either Premium Economy, Business Class or First Class), competition between carriers on the basis of their product offerings is intense. For example, carriers typically offer passengers in their premium cabins enhanced entertainment options, such as sophisticated in-flight entertainment systems, a choice of dining options and dedicated check-in facilities and other ground services (such as a complementary chauffeur service from the passenger's home or hotel to the airport terminal). Increasingly, carriers also offer passengers in their premium cabins seats that convert into a flat bed.

In light of these differences, the Applicants submit that airlines compete vigorously with one another to attract passengers to their premium cabins.

Entry and expansion onto JSA Routes

Since filing their application in May 2003, the Kangaroo Route continues to witness new entry and expansion.

Consumers have unparalleled choice from a host of carriers, including the new service from Virgin Atlantic. Virgin Atlantic is a well established high quality UK carrier who has been successfully competing for 20 years out of London to over 20 destinations – in fact Sydney will be its 23rd destination.

In addition, Emirates has been particularly successful in entering and expanding its presence on the Kangaroo Route. Since commencing services to Australia in 1996, Emirates (on MIDT data) accounts for more than 5% of traffic between Australia and Europe. Emirates currently operates 34 services to Australia and is expected to grow to 49 services by October 2005 when it is likely to offer double daily services to each of Sydney, Melbourne and Perth and daily services to Brisbane.

Gulf Air also commenced daily services between Australia and Europe via the Middle East in November 2003.

To further assist the Commission, a copy of an article about the competitiveness of airfares on the Kangaroo Route, which was printed in The Sunday Times on 26 September 2004, is attached to this submission as **Annexure A**[15]. In addition, the Applicants set out in **Annexure B** passenger numbers and market shares for the London-Sydney and London-Melbourne routes, split between premium and economy cabins and restricted and unrestricted tickets for Summer 2003 and Winter 2003, based on MIDT data and the fare mapping information available to the parties.

Conclusion - competition between carriers for business passengers is intense

For these reasons, the Applicants submit that competition between airlines for business passengers travelling between the United Kingdom and Australia is intense and that the JSA does not result in a substantial lessening of competition in that "market". Further, that competition is likely to increase as mid point carriers, in particular, increase their presence on these routes. Since the formation of the JSA over eight years ago, competition has proven to be vigorous, with carriers such as Singapore Airlines, Malaysia Airlines, Thai Airways, Cathay Pacific and Emirates having successfully grown their market share, including of premium passengers.

4.2 Slots at Heathrow Airport

At paragraph 10.107 of its Draft Determination, the Commission contends that slot constraints at Heathrow Airport serve to prevent entry and expansion in the UK business passenger market. However, all of the evidence demonstrates that access to slots at Heathrow Airport does not constitute a barrier to entry or expansion on the JSA routes. This is demonstrated by Virgin Atlantic, which is about to commence

[15] The Applicants referred to this article in their oral submissions at the pre-determination conference.

offering services to business and leisure travellers between London and Australia, and the ability of carriers to obtain slots from the "slot pool" and "slot exchanges".

The following paragraphs contain a brief summary of how airlines may obtain slots at London Heathrow and **Annexure C** contains a table setting out the most recent data regarding slots obtained and exchanged at Heathrow. As stated at the pre-determination conference, in recent slot exchanges at Heathrow for Winter 2004 slots were obtained by carriers serving, or preparing to serve, the London to Australia route. Qantas obtained 2 daily slot pairs and Virgin Atlantic obtained 4 daily slot pairs (an increase of 25%)[16]. Emirates have obtained an additional slot pair and Gulf Air have increased their operations at London Heathrow. Further, new midpoint carriers such as Etihad have obtained sufficient slots to mount 10 weekly frequencies into Abu Dhabi. In addition, these carriers have obtained slots at London Gatwick Airport, which the Commission has accepted forms part of its defined London market.

<u>Availability of slots from the pool</u>

Each traffic season, the slot co-ordinator gathers available slots into a "slot pool" from which the co-ordinator then allocates slots to applicant carriers. There are four sources of slots available from the pool for allocation for airlines wishing to start new services from Heathrow, as follows:

1. unused slots from the existing slot pool;

2. new slots that become available through increases in capacity at Heathrow. For example, between 1995 and 2003, the number of slots available in the summer traffic season increased from 631 to 678 daily rotations[17];

3. slots returned to the pool under the "use it or lose it" rule; and

4. slots arising from cancellations of service or current carriers failing to apply for historical slots.

<u>New slots</u>

New slots that become available through increases in capacity at Heathrow are made available to both incumbents and new entrants.

As the provisions of the European Slot Regulation[18] provide that 50% of the slots available for distribution in any given season must be allocated to "new entrants", a significant percentage of new slots allocated each year are granted to new players. For example, carriers that currently enjoy "new entrant" status at London Heathrow include Air New Zealand, China Eastern, Korean Air, Thai International and Royal Brunei.

<u>Slot exchanges</u>

Slot exchanges are also common place for airlines at Heathrow and provide opportunities for airlines with no slots to obtain slots, or for airlines to exchange their existing slots for slots with more desirable times. From British Airways' experiences, slot trading at London Heathrow has increased in recent years, which has enabled new entrants to commence operations at London Heathrow and existing carriers to increase the frequency of service from London Heathrow to Asian, Middle Eastern and Australian destinations.

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[16] Virgin Atlantic is presently only using 1 slot pair (to serve North Atlantic routes). The remainder have been placed on loan with other carriers.
[17] Data sourced from Airport Coordination Limited.
[18] Council Regulation 95/92/EEC on common rules for the allocation of slots at Community airports.

Other mechanisms for obtaining slots

It is also possible for carriers with a "joint operation", such as a code share agreement, to share slots. As more and more carriers join alliances in which codesharing is prevalent, the Applicants submit that this mechanism is likely to be used within alliances to optimise slot portfolios.

For the reasons set out in previous submissions to the Commission[19], all carriers wishing to set up operations (or expand their current operations) from Heathrow to Australia are able to obtain at least some slots through slot trading or other slot exchange mechanisms.

Furthermore, the Applicants agree with the Commission's conclusion[20] that business passengers flying to the United Kingdom have a choice of alternative entry points to Heathrow Airport on an origin-destination city-pair basis. For example, alternative London airports to Heathrow (which itself is located approximately 24 kilometres west of London), such as Stansted Airport (although not yet a longhaul airport) and London Gatwick Airport, enjoy excellent rail and road connections with central London. With Stansted Airport and Gatwick Airport being respectively only 70 and 60 minutes away from central London by road and 40 and 30 minutes away from central London by rail, in the context of a 22 to 24 hour flight, the Applicants believe that passengers are less likely to be sensitive to additional elapsed time resulting from travelling to and from an airport other than Heathrow.

Accordingly, the Applicants concur with the Commission that flights from Australia to other airports in the vicinity of London are, in fact, substitutable for Heathrow Airport. For this reason, the Commission's contention that access to slots at London Heathrow is critical to entering or expanding operations in the UK business passenger market is not relevant to the Commission's analysis of the competitive effects of the JSA.

Mixed mode operations

In addition, the UK Government's White Paper on the future of airport development proposes reviewing the use of London Heathrow's two runways. This may lead to the use of "mixed mode" operations, whereby Heathrow's runways would be used for both take-off and landing. It has been reported[21] that a fully mixed mode operation would add around 15% capacity to the airport, including the possibility that more slots would become available for carriers operating services between Australia and the United Kingdom.

5. PREMIUM CABINS & DYNAMIC EFFICIENCY

Premium Cabin Competition: Product and Price

The Commission states that "Qantas submitted in its submission supporting Application A30202 (JSA Authorisation Application in 2000) that competition in the premium cabins is focussed on quality of service rather than price": paragraph 8.73. From this, the Commission appears able to conclude "Qantas has previously advised the Commission that in the premium cabins airlines compete on product not on price": paragraph 10.75.

The precise words employed by Qantas in its submission to the Commission in 2000 were: "...competition in the premium cabins is predominantly based on quality of

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[19] See confidential Attachment 2 (Access to London Heathrow Airport for entry or expansion on JSA routes) to the parties' letter to the Commission dated 6 January 2004.
[20] Paragraph 8.106 of the Draft Determination.
[21] *The Way Forward - The UK's Future of air transport policy White Paper has major implications for the wider airline industry*, Airline Business, February 2004

service"[22]. This does not equate with a statement that Qantas competes on product but not on price in these cabins. Both are plainly interrelated and important to the parties, particularly in light of the high degree of substitutability amongst fare classes, which was addressed in section 1 above.

It is inaccurate to suggest, as the Commission does, that any improvement in Qantas' product offering (such as new flat beds in the business class cabin) that also involves a fare increase is an indication of demand inelasticity and lack of price competition in business class: paragraph 8.63. Upgrading the business class product and matching this with an increase in business class fares is not equivalent to Qantas "getting more for the same product". Instead, premium cabin travellers are now getting an improved service and significantly more personal space at a slightly higher price.

During the Commission's pre-determination conference, Virgin Atlantic submitted that increases in Qantas' business class fares by 10% following the introduction of its new Skybeds was evidence of Qantas' market power. Qantas does not agree with this submission and, to be completely clear, reiterates the points raised in its confidential letter to the Commission on 14 November 2003. Namely, by reducing the number of business class seats, the introduction of Skybeds would have **[CONFIDENTIAL INFORMATION DELETED]**. This reflects Qantas' on-going view that the JSA routes are highly competitive and any attempt to raise prices above competitively set levels would be likely to lead to a loss of passengers to competitors such that the change would reduce overall revenue.

Dynamic Efficiency

The Commission also concludes that the JSA has had a dampening effect on product competition, which is reflected in the timing of Qantas' introduction of flat beds (Skybeds) in business class: paragraph 10.75. According to the Commission, in the absence of the JSA, Skybeds would have been introduced much earlier.

Qantas is unable to identify any reasoning in the Draft Determination to support the Commission's assertion regarding the introduction of Skybeds beyond statements that the Commission "believes" or "considers" this to be the case. There is no basis for the Commission's assertion.

6. NATIONAL INTEREST

In the Draft Determination the Commission confirmed that though it will recognise international competitiveness and national interest benefits associated with the JSA, it does not believe they are benefits of substance: paragraph 11.104.

Qantas and British Airways do not accept the suggestion that "substantial" national interest benefits will only arise in situations where a refusal to authorise conduct results in a direct threat to the viability of Qantas: paragraphs 11.102 and 11.103. Instead, they reiterate their previous submissions in support of a conclusion that the JSA has resulted in significant national interest benefits. In particular, they note[23]:

1. The Commission has previously acknowledged there is a public benefit associated with having a strong, viable international airline and that alliances can contribute to attaining this position.

2. The JSA has been an important factor underpinning the international competitiveness of Qantas and the viability of its services on key routes. Without the JSA, Qantas' presence in a number of international markets and

[22] Commission Final Determination (A30202) dated 10 May 2000 at p.48.
[23] See the parties' "Submission to the ACCC in support of the Application for Authorisation of the Restated Joint Services Agreement" (May 2003) at pp.30 – 31. See also n.4 (NECG Report) at pp.196 – 197.

its position as a strong national flag carrier would be weakened and its ability to support and benefit the Australian economy and society would be lessened.

7. TOTAL SURPLUS TEST

At paragraph 11.15 of the Draft Determination the Commission explicitly acknowledges that when considering whether the JSA arrangements result in a benefit to the public that outweighs any detriment arising from the conduct, the regulator is applying a "consumer surplus standard". That is, "in relation to cost saving benefits, ... when such benefits are not passed on to consumers <u>those benefits are likely to be accorded a lower weight by the Commission</u>".

Qantas and British Airways submit that the Commission has erred in its application of a consumer surplus standard. Instead, where parties have good grounds for concluding that the likely benefits associated with particular conduct outweigh the competitive detriments it is likely to cause, under the test prescribed by the *Trade Practices Act* 1974 they should be entitled to expect that the conduct will be authorised. In the view of the parties', there is no legislative underpinning or judicial authority to support the Commission's use of differential weights when it comes to assessing "consumer" versus "producer" benefits.

Finally, the Applicants submit that in the course of the pre-determination conference Virgin Atlantic fundamentally misapplied the applicable test when it suggested that, despite the Commission's conclusion that the JSA resulted in a small net benefit, any alleged detriment to business travellers should be separately remedied.

8. TERM

Qantas and British Airways submit that the imposition of a five-year term on the authorisation of the JSA is inappropriately short, given:

1. The airline industry involves large-scale investments, which require considerable capital and are based on lengthy life spans. The authorisation term should reflect this need for relatively long term investment planning.

2. The considerable time period and transaction costs associated with preparing for, and completing, the authorisation process. For example, in this instance the process from initial filing to the Commission issuing a draft determination took approximately 15 months, whilst the Applicants spent approximately 6 additional months preparing their application.

9. COMMISSION APPROACH

In the Draft Determination the Commission arrived at many conclusions in opposition to the submissions made and material provided, by the Applicants. As a general comment, these conclusions are not supported by any evidence, but rather appear to reflect opinions held by the Commission. This is notwithstanding the detailed responses to queries provided by both Qantas and British Airways over a period of more than 15 months.

10. GENERAL INACCURACIES

In addition to the specific matters raised above, the parties note for correction the following inaccuracies in the text of the Draft Determination:

Para No.	Original Text	Correct Text
Para. 2.12	BA's current shareholding in Qantas is ***18.93 per cent*** following a further equity issue in which BA did not participate.	BA's current shareholding in Qantas is ***18.25 per cent*** following a further equity issue in which BA did not participate.[24]
Table 4.8	In the column entitled "Financial year ended" there is a year reported as "***2000/02***".	The correct year should be "***2001/02***".
Para 4.18	However, vigorous growth by Virgin Blue has subsequently seen Qantas' market share fall to an estimated ***70 per cent***.	However, vigorous growth by Virgin Blue has subsequently seen Qantas' market share fall to an estimated ***67 per cent***.
Para 4.30	In ***2002/03***, Qantas delivered a profit (before tax)....	In ***2001/02***, Qantas delivered a profit (before tax)....
Para. 9.76	BA has recently ***introduced*** intra-European capacity and is therefore unlikely to have spare capacity....	BA has recently ***reduced*** intra-European capacity and is therefore unlikely to have spare capacity....
Para. 9.117	The submission from NECG that BA has recently ***introduced*** intra-European capacity and therefore is unlikely to have spare capacity....	The submission from NECG that BA has recently ***reduced*** intra-European capacity and therefore is unlikely to have spare capacity....

[24] The Applicants also note that subsequent to the publication of the Draft Determination British Airways sold its equity stake in Qantas.

ANNEXURE A

ARTICLE FROM THE SUNDAY TIMES 26.09.04

September 26, 2004

The Sunday Times

Tie me ticket price down, sport
By Mark Hodson
More airlines flying to Oz should mean lower fares

If you plan to fly to Australia this winter but feel confused by the myriad airlines and routes, brace yourself, because the choice is about to increase. Next month, Royal Brunei will become the latest airline to hop on the so-called kangaroo route between London and Sydney, with Virgin Atlantic following on December 5. Richard Branson says that his daily flights from Heathrow via Hong Kong will give passengers "much-needed competition and choice".

On November 3, Qantas will start its own flights between London and Sydney via Hong Kong, and may decide to take on British Airways by routing through Mumbai. But will this increased activity filter down into cheaper fares? Does Branson really intend to start a price war, as some commentators suggest, or is he merely jumping on a lucrative bandwagon? The early signs are not encouraging for travellers.

Last week, if you had booked a return flight for travel in January from London to Sydney through Trailfinders, you would have paid £809 with Virgin. Coincidentally, this was the same fare quoted by Air New Zealand, Malaysia Airlines and Emirates. BA and Qantas were £3 cheaper, with Singapore Airlines at £792 and Royal Brunei at £829. Only Cathay Pacific was significantly more expensive, at £860.

But read the small print and Virgin's offer does not look so tempting. If you plan to stop over in Hong Kong, Branson will charge you an additional £120. All the other airlines offer free stops: Cathay in Hong Kong, BA and Qantas in Singapore or Bangkok (or both), Emirates in Dubai, Royal Brunei in Brunei and Singapore Airlines in Singapore.

Malaysia Airlines goes one better. It offers a free stopover in Kuala Lumpur and throws in a free return flight to anywhere in mainland Malaysia, or to the islands of Penang and Langkawi. And if you want to fly the other way around the world, Air New Zealand gives you free stops in Auckland and Los Angeles (you pay only the US departure tax, about £15).

Another important factor when flying down under is cabin comfort. Virgin Atlantic is justifiably proud of its individual Upper Class suites, which have seats that flip over to become full-length beds — very nice if you have £3,359 to spare. Back in economy, however, Virgin's legroom is much less generous, with a seat pitch — the distance between the back of your seat and the back of the seat in front — of just 31in.

For more legroom, it is worth considering less obvious carriers such as Malaysia and the South Korean-based Asiana, both of which offer 34in. Air New Zealand also has 34in, while Cathay Pacific, Singapore, Emirates and Royal Brunei offer 32in. BA and Qantas guarantee 31in, but say many passengers get more.

So far, travel agents report that Virgin's flights are not selling particularly well. This could be seen as an opportunity: last week, Trailfinders said Virgin was the only airline with seats to Sydney during the busy Christmas period, including the key departure dates of December 20, 22 and 23.

If you don't intend to fly over Christmas or New Year, it might be worth waiting a few weeks before booking. Last year, when bookings needed a boost, most of the big carriers brought their fares down to about £700. This year, a similar pattern of slow sales is emerging, suggesting that another price drop could be imminent.

It is also worth keeping an eye on special fares. Malaysia currently has a fare of £699, including the free side trip, which must be booked by Thursday. But not even that beats last week's best deal — £632, with Asiana. The airline only flies twice weekly to Sydney, but it offers a 34in seat pitch and a free stopover in Seoul — in both directions, if you wish.

Consolidators worth trying include Austravel (0870 166 2100, www.austravel.com), Ebookers (0870 010 7000, www.ebookers.com) and Trailfinders (020 7938 3939, www.trailfinders.com). All fares include taxes and are valid between January and March.
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ANNEXURE B

MiDT DATA: LONDON-MELBOURNE/LONDON-SYDNEY

SUMMER 2003

		PASSENGER NUMBERS			MARKET SHARE		
OD CITY	**CARRIER**	**Restricted**	**Unrestricted**	**Grand Total**	**Restricted**	**Unrestricted**	**Grand Total**
LON-MEL	QF	28469	5167	33636	30%	27%	30%
	SQ	17840	2520	20360	19%	13%	18%
	BA	14396	5551	19947	15%	29%	18%
	EK	9609	1799	11408	10%	9%	10%
	MH	10373	1032	11405	11%	5%	10%
	CX	5080	223	5303	5%	1%	5%
	OS	2361	1094	3455	2%	6%	3%
	TG	2305	733	3038	2%	4%	3%
	JL	1674	307	1981	2%	2%	2%
	Other	2342	867	3209	2%	4%	3%
LONMEL Total		**94449**	**19293**	**113742**	**100%**	**100%**	**100%**
LON-SYD	QF	50867	9936	60803	28%	27%	28%
	BA	25541	12033	37574	14%	33%	17%
	SQ	25203	4161	29364	14%	11%	13%
	JL	22621	1181	23802	12%	3%	11%
	MH	15162	1713	16875	8%	5%	8%
	EK	10218	1784	12002	6%	5%	6%
	OS	6764	2372	9136	4%	6%	4%
	CX	7417	298	7715	4%	1%	4%
	TG	4075	1750	5825	2%	5%	3%
	KE	3223		3223	2%	0%	1%
	VS	3204	11	3215	2%	0%	1%
	Other	7164	1381	8545	4%	4%	4%
LONSYD Total		**181459**	**36620**	**218079**	**100%**	**100%**	**100%**
Grand Total		**275908**	**55913**	**331821**			

WINTER 2003

		PASSENGER NUMBERS			MARKET SHARE		
OD CITY	CARRIER	Restricted	Unrestricted	Grand Total	Restricted	Unrestricted	Grand Total
LON-MEL	QF	7958	1522	9480	27%	20%	26%
	BA	5427	1479	6906	19%	19%	19%
	SQ	4855	1281	6136	17%	17%	17%
	EK	3787	1952	5739	13%	25%	16%
	MH	2265	543	2808	8%	7%	8%
	CX	2070	117	2187	7%	2%	6%
	TG	1061	178	1239	4%	2%	3%
	OS	493	307	800	2%	4%	2%
	JL	378	65	443	1%	1%	1%
	Other	750	300	1050	3%	4%	3%
LONMEL Total		**29044**	**7744**	**36788**	**100%**	**100%**	**100%**
LON-SYD	QF	22187	4691	26878	31%	25%	30%
	BA	10619	4118	14737	15%	22%	16%
	SQ	8473	3112	11585	12%	16%	13%
	MH	4978	1337	6315	7%	7%	7%
	CX	5462	261	5723	8%	1%	6%
	JL	4955	381	5336	7%	2%	6%
	EK	1891	2830	4721	3%	15%	5%
	TG	2218	763	2981	3%	4%	3%
	OS	1873	1044	2917	3%	5%	3%
	KE	2201		2201	3%	0%	2%
	VS	1476	20	1496	2%	0%	2%
	UA	1436	50	1486	2%	0%	2%
	OZ	1427		1427	2%	0%	2%
	Other	2560	473	3033	4%	2%	3%
LONSYD Total		**71756**	**19080**	**90836**	**100%**	**100%**	**100%**
Grand Total		**100800**	**26824**	**127624**			

ANNEXURE C

SLOTS AT LONDON HEATHROW AND LONDON GATWICK

Note: Unless otherwise stated, all figures in departures per week

VIRGIN ATLANTIC

1. Virgin are using one Flybye slot on US destinations

At London Heathrow, using the 1830 Arrival, 1910 Departure in Spring 2004, Virgin have added:

- 3 departures to Washington Dulles per week (VS55/56);
- departures to Boston per week (VS53/54); and
- 1 departure to New York Newark per week (VS17/18).

2. Growth rate of Virgin's slots

- Spring 1993: 35 per week;
- Spring 1994: 59 per week;
- Spring 1995: 56 per week;
- Spring 1996: 62 per week;
- Spring 1997: 84 per week;
- Spring 1998: 85 per week;
- Spring 1999: 96 per week;
- Spring 2000: 99 per week;
- Spring 2001: 107 per week;
- Spring 2002: 95 per week;
- Spring 2003: 113 per week;
- Spring 2004: 142 per week [Note: Spring 2004 includes 20 departures per week to Lyon covered by Air France.]

EMIRATES

1. Emirates' schedules at London Heathrow and London Gatwick

Heathrow: Emirates have 4 daily departures in Spring 2004 and Winter 2004.

Gatwick: Emirates have 3 daily departures in Spring 2004 and Winter 2004.

2. Growth rate of Emirates' slots

- Spring 1993: 7 per week;
- Spring 1994 – Spring 1998: 14 per week;
- Spring 1999 – Spring 2003: 21 per week;
- Spring 2004: 28 per week.

ETIHAD

1. Etihad's schedules at London Heathrow and London Gatwick

Heathrow: Etihad began operating at London Heathrow in Spring 2004 with 5 departures per week. Eithad commenced additional services on 14 June 2004, such that it now has 10 departures per week. For Winter 2004, Etihad have 8 departures per week from London Heathrow (one departure per day, as well as a second departure on Saturdays).

Gatwick: Etihad began operating at London Gatwick on 1 September 2004 with 3 departures per week. Etihad has a daily departure in Winter 2004.

2. Growth rate of Eithad's slots

- Spring 2004: 10 per week - their first season at London Heathrow.

GULF AIR/QATAR

1. Gulf Air/Qatar schedules at London Heathrow and London Gatwick

Heathrow: For Spring 2004 Gulf Air has 13 departures per week to Abu Dhabi, 14 departures per week to Bahrain and 7 departures per week to Seeb (Oman). Qatar has 14 departures per week to Doha.

For Winter 2004 at London Heathrow, Gulf Air have 10 departures per week to Abu Dhabi, 14 departures per week to Bahrain, and 7 departures per week to Seeb (Oman). Qatar have 14 departures per week to Doha.

Gatwick: For Spring 2004, neither Gulf Air nor Qatar have any slots. For Winter 2004, Qatar has one daily departure for Doha.

2. **Growth rate of Gulf Air slots**

- Spring 1993 - Spring 1997: 26 per week;
- Spring 1998 - Spring 2001: 27 per week;
- Spring 2002: 26 per week;
- Spring 2003: 27 per week;
- Spring 2004: 34 per week.