



Australian Government

International Air Services Commission

DETERMINATION

Determination: [2004] IASC 112
The Route: United Kingdom
The Applicants: Qantas Airways Ltd (ACN 009 661 901) (Qantas) and Backpackers Xpress Pty Ltd (ACN 104 183 851) (Backpackers Xpress)
Public Register File: IASC/APP/200403

1 The applications

1.1 On 17 February 2004, Qantas applied for an allocation of seven services per week on the United Kingdom (UK) route. Qantas plans to commence three B747 services per week between eastern Australia and London in November 2004. Four additional flights are planned to be phased in during 2005, so that all the capacity sought would be fully utilised by November 2005. The introduction of the seven services would bring to 28 the total number of services operated by Qantas to London. Qantas advised that the intermediate points to be served would be decided at a later time. Qantas noted that timeslots to operate the services had been obtained at London's Heathrow airport. Qantas sought permission for British Airways to code share on the proposed services, under the terms of the Restated Joint Services Agreement (JSA) between the two airlines.

1.2 In response to the Qantas application, the Commission published a notice on 23 February 2004 inviting other applications for all or any part of the capacity sought by Qantas. On 1 March 2004, an intention to apply for capacity on the UK route was received from Backpackers Xpress. An application from Backpackers Xpress was received on 24 March 2004.

1.3 Backpackers Xpress sought an allocation of three services per week on the UK route. Backpackers Xpress proposed to commence services from November 2004, using B747 aircraft. In its application Backpackers Xpress addressed both the paragraph 4 and 5 criteria in the Minister's policy statement.

1.4 The Commission published a notice on 30 March 2004 inviting submissions about the Qantas and Backpackers Xpress applications. Qantas was also invited by the Commission to elaborate on its original application by addressing the paragraph 5 criteria in the Minister's policy statement.

1.5 Submissions were received from Tourism Victoria (6 April 2004), British Arms International Backpackers (6 April 2004), Hotel Bakpak (8 April 2004) and Melbourne Airport (late April 2004).

1.6 Qantas wrote to the Commission on 4 June 2004 providing a supplementary submission, including a summary of claims against the paragraph 5 criteria on the United Kingdom route. Backpackers Xpress responded to the Qantas submission in a letter of 12 July 2004.

1.7 As Backpackers Xpress had sought only three services per week of the seven sought by Qantas on the UK route, and there were no other applications, the Commission has separately considered Qantas' application in respect of the remaining four services. In Determination [2004] IASC 102 the Commission allocated four services per week of capacity on the UK route to Qantas.

1.8 All public material supplied by the applicants and by submitters is filed on the Register of Public Documents. Commercial in confidence material provided by the applicants is filed on the Commission's Confidential Register.

1.9 Backpackers Xpress also applied for allocations of capacity on the India, Germany and Thailand routes. The application for capacity on the India route is the subject of an earlier determination by the Commission ([2004] IASC 104). The outstanding applications for capacity on the Germany and Thailand routes are discussed in Section 7 of the Commission's assessment, below.

2 Current services on the United Kingdom route

2.1 There are extensive services provided on the United Kingdom route. Qantas is the only Australian airline on the route and the principal carrier of end-to-end (origin – destination) traffic between Australia and the UK (see market shares in section 4 below). Extensive competition is provided by many third country carriers, with Singapore Airlines capturing the greatest market share after Qantas. Virgin Atlantic is expected to enter the direct market with services via Hong Kong either late in 2004 or early in 2005.

3 Provisions of relevant air services arrangements and capacity available for allocation

3.1 The air services arrangements between Australia and United Kingdom permit multiple designation of airlines. The Register of Available Capacity shows that there are three services per week available for allocation to Australian carriers on the UK route. Code sharing is permitted between designated airlines of Australia and the UK.

4 Characteristics of the Australia – United Kingdom route

AUSTRALIA – UK TRAFFIC GROWTH

Traffic category	Year ended April				Compound annual growth rate 01-04	
	2001	2002	2003	2004		
Direct traffic (Annual % change)	626,200	614,600 (-1.9%)	603,500 (-1.8%)	662,300 (+9.7%)	(28.2%)	1.9%
Indirect traffic (Annual % change)	1,323,800	1,264,300 (-4.5%)	1,393,700 (+10.2%)	1,480,700 (+6.2%)	(62.9%)	3.8%
Beyond traffic (Annual % change)	213,700	177,400 (-17.0%)	173,200 (-2.4%)	209,600 (+21.0%)	(8.9%)	-0.6%
Total traffic (Annual % change)	2,163,800	2,056,300 (-5.0%)	2,170,400 (+5.5%)	2,352,600 (+8.4%)	(100.0%)	2.8%

AUSTRALIA – UNITED KINGDOM ORIGIN/DESTINATION AIRLINE MARKET SHARE FOR YEAR ENDED APRIL 2004

AIRLINE	MARKET SHARE
Qantas	31.9%
Singapore Airlines	17.0%
British Airways	10.4%
Emirates	9.2%
Malaysia Airlines	8.9%
Cathay Pacific Airways	4.0%
Japan Airlines	3.9%
Other	14.8%
Total	100.0%

5 Summary of applicants' claims against the paragraph 5 criteria

5.1 The claims of the two applicants against the paragraph 5 criteria in the Minister's policy statement, and responses by each to submissions of the other, is attached.

6 Summary of other submissions

6.1 British Arms International Backpackers supported the Backpackers Xpress proposals, arguing that the services would increase the number of backpackers visiting Australia and this would benefit all Australians. Backpackers would benefit from safe, entertaining and friendly travel provided at low cost, meaning they would have more money available to spend in Australia.

6.2 Tourism Victoria supported the proposals from Backpackers Xpress, subject to financing, licensing approvals and capacity being available. Tourism Victoria encouraged discussions between the aeronautical authorities of Australia and United Kingdom with the aim of securing additional rights.

6.3 Hotel Bakpak endorsed the Backpackers Xpress proposals. It argued that the proposed services were necessary for the continued growth of the backpacking industry and that the routes proposed to be serviced were of great importance. Hotel Bakpak stated that the backpacking industry continues to grow strongly, evidenced by increasing numbers of backpackers as a proportion of inbound tourism arrivals. Spend and length of stay by backpackers were also increasing. State and Federal tourism ministries and tourism bodies were giving greater recognition to the backpacker market.

6.4 Melbourne Airport supported the Backpackers Xpress proposals. It argued that the airline would offer additional capacity offering opportunities for Australian tourism and aviation. It would bring Australia into the low cost airline international market. The airline would bring needed growth to Melbourne airport. Victoria has suitable accommodation and transport infrastructure for the backpacker market, including a new Accor group property opened in April 2004. The additional capacity to Melbourne would also serve the tourism interests of Tasmania. Melbourne provides a major domestic hub for distribution of tourists to other destinations. In relation to United Kingdom, Melbourne Airport noted that there are no direct services. United Kingdom is identified as a key growth market by major tourism bodies. The limits on available bilateral capacity were noted and the desirability of expanding negotiated capacity expressed. Melbourne Airport also commented on the Germany and Thailand markets. Finally, Melbourne Airport observed that Qantas was offering fewer international seats to Melbourne than in the past. In light of this, other airlines seeking to operate to Melbourne should be accommodated.

6.5 A number of proforma submissions were received from individuals supporting the Backpackers Xpress application. These submissions raised concerns that Qantas would be allocated all of the remaining capacity on the UK route and thereby deny backpackers the choice of an airline tailored to their needs.

7 Commission's assessment

Introduction

7.1 The Commission's first task is to determine the public benefit criteria which are relevant to the circumstances of this case. In addition to the paragraph 4 criteria in the Minister's policy statement, the additional criteria in paragraph 5 of the policy statement are also applicable in assessing the benefit to the public in all circumstances other than is provided in relation to particular circumstances set out in paragraph 6 of the policy statement. In this case there are competing applications for capacity which together exceed the amount of capacity available. In these circumstances, the paragraph 5 criteria are applicable.

7.2 However, as there is a prospective new entrant applicant in this case competing for limited capacity with an established operator on the route, the Commission must also consider whether the paragraph 7 allocation criteria which relate to the start up phase of a route are applicable in this case. Paragraph 7.1 of the policy statement states that: "Where capacity is limited under a bilateral arrangement, during the start up phase in relation to any route on which an Australian carrier is already operating scheduled international services, the pre-eminent consideration is to introduce competition on the route through the allocation to an *initial* (italics added) new entrant of sufficient capacity to develop an efficient and commercially sustainable operation. The Commission should therefore allocate such capacity to an initial new entrant provided it is satisfied that:

- (a) the level of capacity available and in prospect is sufficient to support efficient, commercially sustainable operations by both a new entrant and an incumbent Australian carrier;
- (b) the new entrant's tariff and service proposals would enhance competition on the route;
- (c) approval would not result in a decrease in inbound tourism to Australia or to Australian consumer benefits or trade; and
- (d) the new entrant is reasonably capable of obtaining the necessary approvals and commencing operations as proposed."

7.3 A threshold issue for the Commission to decide is whether the start-up provisions are still relevant to the UK route. As defined in paragraph 2.1 of the policy statement, the "start up phase means, in relation to any route, the period from 1 July 1992, or from such later date as a particular bilateral arrangement becomes subject to the Act in order that available capacity under that arrangement may be allocated by the Commission, until the date on which a determination has been made under the section 7 or 8 of the Act allocating a commercially sustainable level of capacity on the route to a new entrant."

7.4 In this respect, the Commission has previously allocated to Ansett International (a new entrant) capacity totalling 675 seats per week on the UK route (see

IASC/DET/9903 and variations to that determination), at a time when there was an Australian carrier (Qantas) already operating scheduled international services. However, Ansett International did not use its allocated capacity to operate services in its own right. Rather, it used the capacity in code share arrangements with Singapore Airlines and Thai Airways. Under these arrangements, Ansett International sold a comparatively small number of seats on each of a number of code share flights operated by Singapore Airlines and Thai Airways between Australia and London and Manchester in the UK.

7.5 The judgement for the Commission to make is whether the allocation of the code share capacity to Ansett International on the UK route should be considered to be an amount of capacity sufficient to develop an efficient and commercially sustainable operation, for the purposes of the start up provisions of the policy statement. The Commission's view is that an amount of 675 seats per week would not be sufficient to develop an efficient and commercially sustainable operation by a carrier operating its own services. With this number of seats, Ansett International would have had too small an allocation to operate more than one B747-400 service per week, or two services per week with smaller aircraft, on the route in its own right. On a highly contested long haul route such as the UK route, such a level of services is unlikely to be either efficient or commercially sustainable. The Commission considers that the sale by Ansett International of a relatively small number of code share seats per week did not constitute an efficient and commercially sustainable operation. Indeed, as Ansett International did not operate any services, it is questionable whether its code share capacity would meet the definition of an operation within the meaning of the policy statement.

7.6 Accordingly, the Commission concludes that the start-up phase in relation to the UK route has not ended, as there has not been an allocation to an initial new entrant of an amount of capacity sufficient to develop an efficient and commercially sustainable operation. As a result, the Commission will apply the provisions of paragraph 7.1 of the policy statement in this case. This means that if the Commission is satisfied that Backpackers Xpress, as the prospective new entrant, meets all of the elements of paragraph 7.1, the Commission should allocate to it an amount of capacity sufficient to develop an efficient and commercially sustainable operation. Should this amount be less than the three services per week, the Commission would apply the paragraph 5 criteria in relation to the balance of the capacity in determining whether that should be allocated to Qantas or Backpackers Xpress.

7.7 Should the Commission not be satisfied that Backpackers Xpress meets the paragraph 7.1 criteria, then the Commission would allocate all of the capacity to Qantas, an established operator which meets the paragraph 4 criteria of the Minister's policy statement.

7.8 The Commission notes the policy statement's requirement that the pre-eminent consideration is to introduce competition on the route through the allocation of capacity to an initial new entrant of capacity sufficient to support efficient, commercially sustainable operations. The Commission is satisfied that the allocation of three services per week of capacity on the UK route to Backpackers Xpress would meet the requirements of sub-paragraphs 7(a), (b) and (c) of the policy statement. The

Commission considers that three services per week represents an amount of capacity sufficient Backpackers Xpress to develop an efficient and commercially sustainable operation, together with capacity Backpackers Xpress has sought on the Germany route. Together this would enable Backpackers Xpress to operate daily services to and from Australia. As far as the provisions of paragraph 7(a) are concerned with the interests of the incumbent airline, the Commission notes that Qantas already operates 21 services per week on the UK route and holds an allocation from the Commission enabling it to introduce a further four services per week. This is sufficient to support efficient and commercially sustainable operations by the incumbent.

7.9 In relation to paragraph 7(b), the Commission considers that Backpackers Xpress' tariff and service proposals would enhance competition on the route. The Commission notes that Backpackers Xpress offers an all-year round pricing approach, which distinguishes it from the more segmented pricing strategies of Qantas or other airlines. Also, the Backpackers Xpress product is unique and offers travellers service options which are not available on other carriers.

7.10 Turning to paragraph 7(c), the Commission is confident that the Backpackers Xpress proposal would not result in decreased inbound tourism or a lessening of Australian consumer benefits or trade. Indeed, there are likely to be enhancements in all these respects arising from the Backpackers Xpress proposals.

7.11 The stumbling block to the allocation of capacity remains the ability of the applicant to demonstrate that it is reasonably capable of obtaining the necessary approvals and commencing operations as proposed (paragraph 7.1(d)). The Commission has previously assessed Backpackers Xpress against the paragraph 4 criteria, in relation to its application for capacity on the India route (essentially the same criteria as those in paragraph 7.1(d)). In Determination [2004] IASC 104 of 29 June 2004, the Commission found that Backpackers Xpress was not capable of implementing its application at that time and therefore did not meet the requirements of paragraph 4 of the policy statement. However, the Commission considered that Backpackers Xpress may have been able to meet the paragraph 4 requirements given additional time. It therefore deferred further consideration of the UK case until now, allowing Backpackers Xpress a further several weeks in which to demonstrate that it is able to obtain the necessary approvals and of implementing its application.

7.12 In the intervening period, the Commission has received additional information from Backpackers Xpress, but essential requirements are yet to be satisfied. The Commission is not satisfied that Backpackers Xpress is likely to be capable of implementing its application, by the proposed start-up time of November 2004. Important aspects of the applicant's business plan are yet to be fulfilled.

7.13 The Commission concludes that Backpackers Xpress does not meet the paragraph 7.1(d) (or equivalent paragraph 4) requirements. The Commission considers it is possible that Backpackers Xpress could meet those requirements given further time, but the Commission cannot be sure that it will be able to do so.

7.14 The Commission considers that it should not delay further a decision on this matter. Qantas is an established applicant which the Commission is confident will be

able to utilise the capacity if allocated, and plans to begin doing so from November 2004. An allocation to Qantas would offer less competition and other public benefits than would the Backpackers Xpress proposal, were the Backpackers Xpress proposal definitely to be capable of implementation. However, the public benefits that Qantas will deliver through the use of the capacity can be anticipated with a high degree of certainty, compared with the uncertain situation were Backpackers Xpress to be allocated the capacity at this time.

Paragraph 5 assessment

7.15 The Commission has decided it is unnecessary to conduct a paragraph 5 assessment. The Commission considers that only the provisions of paragraph 7.1 are relevant in the circumstances of this case.

Conclusion

7.16 The Commission finds public benefit on the United Kingdom route is likely to be maximised by the allocation of all of the available capacity to Qantas. Accordingly, the Commission will issue a determination allocating three services per week to Qantas on the United Kingdom route. The Commission considered issuing a draft determination in this case, but considers that there would only be point to doing so if both applicants were capable of implementing their applications as proposed (in other words, from November 2004).

7.17 The Commission notes that Qantas plans to utilise two of the three services by November 2004 with the third service to be used by November 2005, or possibly sooner. The Commission will require the services to be implemented no later than these dates. The determination will be for a period of five years from the date of the determination.

7.18 Under Section 15(2)(e) of the Act, the Commission must include a condition in determinations stating the extent to which the carrier may use that capacity in joint services with another carrier. The Commission proposes to authorise the use of the capacity in joint services with British Airways on terms consistent with those in the other determinations allocating capacity to Qantas in which the operation of joint services between the two carriers is authorised.

7.19 Prior to finalising this determination, the Commission received advice from Backpackers Xpress that it was withdrawing its applications for allocations of capacity on the Germany and Thailand routes. The Commission's consideration of those applications is therefore concluded.

7.20 The Commission concludes with some comments about this case. The Commission is aware that Backpackers Xpress has been working for a considerable time to bring its enterprise to the point of operation. Considerable resources have been invested in doing so. Backpackers Xpress is perhaps unfortunate that its preparations for operations were not as far advanced as it may have wished when the applications from

Qantas for capacity on the India and United Kingdom routes were made. As Qantas had sought all of the capacity remaining available for both routes, Backpackers Xpress considered that it had no choice other than to lodge competing applications earlier than it would have done in other circumstances.

7.21 The Commission considers that Backpackers Xpress may be capable of implementing its proposals, given further time to prepare its business and meet regulatory requirements and, importantly, the presence of adequate opportunities under the relevant bilateral arrangements. The Commission notes that the consequence of its determinations in this case, and in the earlier India case, means that there is no capacity available for allocation on either the India or UK routes. This means that the ambitions of Backpackers Xpress cannot be furthered until this situation changes. The absence of available capacity on the UK route is particularly problematic for Backpackers Xpress, as the UK market is a major source of backpacker visitors to Australia. This traffic substantially underpins the Backpackers Xpress business model.

7.22 Responsibility for the negotiation of bilateral capacity rests with the Department of Transport and Regional Services. The Commission understands that air services consultations are scheduled with the Indian authorities, but that more difficulty is being experienced in committing the UK authorities to discussions. The Commission hopes that the Department will be successful in expanding opportunities for Australian carriers (beyond any stated future plans of the incumbent) in both cases as soon as possible. The absence of opportunities for prospective new Australian carriers, particularly on major routes, leaves no scope for competition from such carriers in the relevant markets. This lack of potential competition limits the possibilities for increased public benefits from the operation of international air services by Australian carriers.

8 Determination allocating capacity on the United Kingdom route to Qantas [2004] IASC 112

8.1 The Commission makes a determination in favour of Qantas, allocating three services per week in each direction on the Australia – United Kingdom route, in accordance with the Australia – United Kingdom air services arrangements.

8.2 The determination is for five years from the date of the determination.

8.3 The determination is subject to the following conditions:

- Qantas is required to utilise two of the three services per week from 1 November 2004 and to fully utilise the capacity from 1 November 2005;
- only Qantas is permitted to utilise the capacity;
- the capacity may be used by Qantas to provide services jointly with British Airways in accordance with:
 - the code share agreement dated 5 October 1997; or

- any new code share agreement, whether or not it replaces the existing agreement, with the prior approval of the Commission;
- under the arrangements with British Airways, Qantas may only price and market its services, or share or pool revenues/profits on the route, jointly with British Airways as long as such practices are authorised under the *Trade Practices Act 1974* or otherwise authorised by the Australian Competition Tribunal, in the event of review by that Tribunal;
- changes in relation to the ownership and control of Qantas are permitted except to the extent that any change:
 - results in the designation of the airline as an Australian carrier under the Australia – United Kingdom air services arrangements being withdrawn; or
 - has the effect that another Australian carrier, or a person (or group of persons) having substantial ownership or effective control of another Australian carrier, would take substantial ownership of Qantas or be in a position to exercise effective control of Qantas, without the prior consent of the Commission; and
- changes in relation to the management, status or location of operations and Head Office of Qantas are permitted except to the extent that any change would result in the airline ceasing to be an airline designated by the Australian Government for the purposes of the Australia –United Kingdom air services arrangements.

Dated: 30 July 2004

John Martin
Chairman

Michael Lawriwsky
Member

Stephen Lonergan
Member

Introduction

Qantas

8.4 Qantas provided substantial information in its supplementary submission as background to its claims against the paragraph 5 criteria. As summary of that background information is as follows.

8.5 Qantas advised that the operational plans outlined in its original application had changed as a result of opportunities arising from an expansion of bilateral entitlements on the Hong Kong route. As a result, Qantas plans to commence three services per week from Sydney via Hong Kong to London from November 2004, as well as a once weekly Perth – Singapore – London service. These services will utilise the four services per week allocated by the Commission to Qantas recently. Qantas plans to use the three weekly services the subject of consideration in this determination to operate a further two weekly Perth – Singapore – London services (November 2004) and a fourth weekly Sydney – Hong Kong – London service by November 2005. Qantas has the timeslots at Heathrow airport necessary to implement all six additional services commencing in November 2004.

8.6 Qantas provided a detailed description of the services it and Australian Airlines operates to and via Singapore, Bangkok and Hong Kong, as well as future plans for expansion in capacity and frequency. Refer to the Qantas submission for details.

8.7 Qantas also summarised the activity levels at Heathrow airport and the importance of the airport to Qantas. Heathrow is the UK's major gateway and hub airport. All of the Qantas expansion to the UK over the next three to five years will be at Heathrow airport. Qantas uses Heathrow as its primary European gateway and carries more than 200,000 passengers per year to and from cities in continental Europe and Ireland. Qantas is able to maximise its interline co-operation with other carriers by concentrating services at Heathrow. Other UK cities are served via London by Qantas code sharing on British Airways flights to those points.

8.8 Qantas stated that the flights that would be operated if the capacity under consideration in this determination was available to it would not be dedicated solely to UK/Europe traffic. These Perth – Singapore – London (two per week) and Sydney – Hong Kong – London services (one per week) would also serve south east Asian points to Australia, China to Australia and vice versa, as well as the long haul Uk/Europe markets.

Backpackers Xpress

8.9 Backpackers Xpress provided a statement of claims against the paragraph 5 criteria in its original application. These claims are summarised below. In its response of 12 July to the Qantas 4 June supplementary submission, Backpackers Xpress provided a summary of recent developments in its progress towards endeavouring to become operational. Those developments included:

- Seed capital for the start-up phase was in place
- The Information Memorandum, required to seek major funding, was nearing completion. Meetings to discuss acquisition of operational capital had been arranged
- Applications for the position of Chief Executive Officer had been received
- Meetings were taking place with key personnel in the UK concerning fuel purchasing, freight and sales
- Offers had been received in response to requests for tender for various aspects of the airline operation
- A freight management contract had been signed
- Offers to act as General Sales Agent for Backpackers Xpress had been received
- Offers for terminal and office space at airports were being reviewed
- The process was underway for obtaining an Air Operators Certificate. Documentation was about 85% completed.

8.10 Backpackers Xpress also responded to a number of Qantas claims against the paragraph 5 criteria, and these responses are summarised below.

Summary of applicants claims against the paragraph 5 criteria.

8.11 The claims of Backpackers Xpress and Qantas against the paragraph 5 criteria in the Minister's policy statement are as follows.

Tourism benefits

Backpackers Xpress

8.12 Sales and marketing plans have been developed. Formal understandings have been reached with travel industry outlets which focus on backpacking and independent travel. Travellers in this demographic are prolific users of the internet and the Backpackers Xpress website will be a major tool for booking trips. There is potential for Backpackers Xpress to integrate its services with other low cost carriers within Australia.

Qantas

8.13 Qantas argued that the tourism benefits of its proposed services needed to be considered in the context of its total operations set out in the first part of its supplementary submission. Qantas stated that it served a range of visitor market segments and only by doing this is the airline able to generate the volume of traffic entering Australia. These segments included business travellers, VFR traffic, holiday

traffic including group and individual package travellers, backpacker traffic, educational travel and other specialist market segments including the international conventions and incentives market.

8.14 In relation to the backpacker market specifically, Qantas estimates that 130,000 passengers originate from the UK, of a total visitor market to Australia of about 460,000 passengers. Qantas supports the student/youth market through its relationships with key agents. It offers rates lower than those available through the Qantas distribution network. Qantas also sells to this market by other means, including online for point to point fares and other wholesale and retail agents and tour operators. STA Travel is a key agent in this market segment and Qantas works with it including via an annual promotion of Australia in STA offices. Qantas is also active in Germany.

8.15 Qantas provided information about its pricing in a confidential attachment to its submission. As a general observation, Qantas stated that price competition was fierce between the major scheduled operators.

8.16 Qantas outlined the travel options available to visitors to Australia behind its international gateways. Travellers have the option of flying on Qantas or Jetstar services, with Qantas code sharing on all Jetstar flights. Passengers can also extend their travel to and within New Zealand on Qantas' trans-Tasman services and domestic New Zealand services.

8.17 The intermediate points provided on Qantas services offer passengers a range of travel choices, including a new stopover option associated with the introduction of services via Hong Kong, and non-stop services from Hong Kong to Australian cities. UK passengers travelling from points other than London to Australia will be able to connect with the new Qantas services from Heathrow. Similarly, Qantas offers code share services from 15 continental European airports to London, providing access to Australia on Qantas flights. In addition, Qantas has interline agreements with a number of carriers involving special pro-rate arrangements enabling attractive prices to be offered to passengers originating from within Europe.

8.18 The introduction of services via Hong Kong provides UK/Europe travellers with choice of carrier for the first time for those wishing to stopover in Hong Kong but use the same airline over the whole route. Currently, Cathay Pacific is the only carrier which provides this option. Qantas notes that the proposed entry of Virgin Atlantic onto this routing later in 2004 or early in 2005 will add a further choice for such passengers.

8.19 Qantas has a major distribution network with the UK and Europe to support its proposed new services. British Airways code shares on Qantas flights to Australia and other sectors and markets these flights to British Airways customers.

8.20 Qantas spends about \$20 million per annum in marketing Australia overseas, including in conjunction with government tourism bodies. Qantas is working with the new tourism body, Tourism Australia, to support its European tourism initiatives. The addition of new London – Australia services should contribute to the success of Tourism Australia's marketing efforts.

Backpackers Xpress response to Qantas

8.21 Backpackers Xpress referred to a statement in the Qantas submission that seasonal high density all economy class flights could not be sustained in competition with the scheduled carriers and were withdrawn years ago. Backpackers Xpress argued that this was a generalisation and that the airline industry had changed significantly in the past decade. Backpackers Xpress pointed out that Qantas itself had entered the “low cost all economy” airline model in Australia and South East Asia.

8.22 Backpackers Xpress argued that Qantas statements and information about fierce price competition between the major scheduled operators is of limited relevance. Backpackers Xpress said that Qantas had not provided either the average ticket price per seat or how many seats were actually made available at the stated low fare levels (£500-510 round trip). Also, the information was only relevant to travel during June and not the peak (ex-UK) December/January season.

8.23 By contrast, Backpackers Xpress pricing is available for all services and not a one-off offer, a special sales price, or capped to a certain number of seats per service. Further, the Backpackers Xpress tickets are fully flexible and unconditional, valid beyond the 12 month validity period offered by Qantas.

Australian consumer benefits

Backpackers Xpress

8.24 An all economy seat plan and pricing structure. Integrated services to travellers including accommodation, domestic travel and adventure sports. Manchester is the chosen port. It has attractions through an environment unaffected by congestion, curfews and slot constraints. Manchester is well located for backpacker travel from Ireland, Scotland and the southern and midland regions. The airport is a hub for some low cost European carriers, enabling passenger transfer to/from mainland Europe. Delhi and Bangkok provide attractive stopover points.

8.25 On pricing, the aim is to achieve the lowest cost fares with open dated return tickets, providing flexibility to travellers. There will be a range of onboard services and entertainment, including live performers, cultural demonstrations, a bar and dvd hire. All of these represent innovative benefits to consumers that are likely to stimulate a response from incumbent carriers.

Qantas

8.26 The additional Qantas services would provide similar benefits to Australian consumers as those that would arise for tourist visitors to Australia. Qantas serves all Australian traveller market segments with a three class service on its B747-400 aircraft. By serving a wide range of consumers, Qantas considers that it can optimise the public benefits associated with the new capacity and frequency. Qantas will also offer competitive prices in the market, and provided details in a confidential attachment to its submission.

8.27 The addition of flights via Hong Kong adds a new element of choice for Australian consumers for travel between Australia and Europe. Passengers have a range of non-stop or stopover options via Hong Kong, Bangkok or Singapore.

8.28 The addition of new services Perth – London will provide Perth passengers with three same-aircraft B747-400 flights per week via Singapore. The additional Singapore – London sector services provide additional flight options for passengers arriving in Singapore from other Australian points.

8.29 Passengers travelling beyond London will have extensive code share and interline options to a range of cities in the UK and to other countries in Europe.

8.30 Qantas has a large distribution network giving Australian consumers easy access to Qantas services and fares. Tour operators have a wide range of options to design travel packages, taking advantage of the Qantas international services and behind gateway services both in Australia and the UK. Australian travellers also have the opportunity to join Qantas' frequent flyer scheme and so earn and redeem points on eligible Qantas services worldwide, plus those on partner airlines.

Trade benefits

Backpackers Xpress

8.31 Freight activities will be subcontracted to a freight forwarding company which will be responsible for selling space and physical handling of freight. Melbourne and Manchester are high volume freight airports which will be to the advantage of Backpackers Xpress. As the aircraft will be operating on relatively short sectors, maximum freight capacity will be available for sale.

Qantas

8.32 Qantas stated that all major freight forwarders and express freight companies are based at Heathrow and international freight to and from the UK is processed and consolidated there. Airmail is also centralised and processed through the London Air Mail unit located at Heathrow. As two of the Qantas London services related to this application will operate to and from Perth, in addition to other Perth flights, Qantas will be able to offer West Australian exporters direct same day service to London on three days per week. Qantas freight capacity will be sold through its network of freightforwarders.

Backpackers Xpress response to Qantas

8.33 Backpackers Xpress says it will offer affordable freight services from Melbourne airport, Australia's largest airfreight export airport, at more competitive rates than Qantas. Backpackers Xpress is able to achieve this through its low-cost structure.

Competition benefits

Backpackers Xpress

8.34 The introduction of another Australian carrier would diminish some of the conditions of market failure that are a consequence of monopoly Australian operations. The entry of Backpackers Xpress to the route would promote fairer pricing, better services and overall efficiency. None of the airlines currently operating on the route meet the needs of backpacker travellers in the way envisaged by Backpackers Xpress. The low cost market is not one that Qantas wants to serve on long haul routes and Backpackers Xpress will be able to compete effectively with Qantas in the market for backpacker travellers.

8.35 Backpackers Xpress will operate using a low cost model and its pricing will be very competitive relative to other carriers. The available price will be for all services regardless of season and not on a one-off or special sale basis. Tickets will be fully flexible and unconditional with open-ended use. Pricing has been derived from conservative assumptions. The proposed routing will give passengers increased choice of where and when to travel.

8.36 Backpackers Xpress will provide a travel experience rather than just flight service. It will involve a combination of services and facilities never before offered by any other carrier. It will thus be sharply differentiated from all other airline services. It will directly facilitate the wants and needs of the backpacking traveller.

8.37 All services will be operated by Backpackers Xpress. There will be no code sharing with other carriers.

Qantas

8.38 Qantas stated that competition benefits must be considered in the context of the overall competitive situation on the UK route. Although Qantas is the only Australian carrier, it competes with many foreign airlines operating between Australia and the UK. Qantas provided details of the services provided by five main competitors during the Northern Summer scheduling period, totalling 208 round trip services weekly from Australia and 384 round trip services to UK/Europe.

8.39 Qantas argued that to maintain its competitive position against the hub carriers, it requires significant volumes of capacity and frequency and needs to operate on the major city pairs where demand is concentrated. Qantas is able to compete because of its scale, marketing presence, marketing network and by operating to Heathrow. The increased competition the new services would bring would be permanent.

8.40 Qantas said that it may seem that having an additional Australian carrier operating on the route would promote competition, but this may not be so. A new carrier operating only three services per week to Manchester would be unlikely to optimise the use of this scarce capacity. It may result in lower Australian carrier market share than if the capacity was able to be used by Qantas to compete with foreign carriers.

Backpackers Xpress response to Qantas

8.41 Backpackers Xpress said that the Qantas assertions about competition benefits that would arise from its proposal were erroneous. Allocation of the capacity to Backpackers Xpress would promote competition both with the incumbent Australian carrier but also amongst other international operators on the route. The Qantas proposition that the introduction of a low cost all economy backpacker focussed operator would not be an efficient allocation of resources was illogical.

8.42 Backpackers Xpress argued that its services would be differentiated from existing operators. If Qantas was granted all of the capacity this would increase supply. However, Qantas had not identified whether this would lead to cheaper seats for passengers, provide better service or bring any product differentiation from incumbent carriers. Backpackers Xpress argued that passengers on Qantas services would receive a product and service similar to that already being offered by established carriers, and would be marketed towards the business and high-end traveller.

8.43 Backpackers Xpress also noted that Qantas has already been allocated 25 of 28 services per week on the UK route and is seeking the balance of the available capacity. Qantas had also sought all of the available capacity beyond Hong Kong to the UK. Backpackers Xpress argued that the allocations already made to Qantas were sufficient for it to operate profitable services from Australia to the UK.

Industry structure

Backpackers Xpress

8.44 The Backpackers Xpress low cost model will provide a carrier that complements the existing and future domestic aviation sector. Backpackers Xpress will provide extensive employment and business opportunities within the Australian aviation industry and associated secondary and tertiary sectors. In the direct aviation sector there will be employment opportunities for pilots and flight attendants, engineers and technicians, ground and service crew and other customer and support staff. There will be business opportunities associated with fitting the aircraft and in providing aircraft, airport and technical infrastructure.

8.45 There will be flow on benefits for businesses in areas such as catering, cleaning and uniform design and supply.

8.46 Backpackers Xpress' services will provide on-carriage of passengers particularly to low cost Australian domestic carriers such as Virgin Blue and Jetstar.

Qantas

8.47 Qantas stated that its additional services would have a positive impact on the Australian industry. The new services are part of Qantas' plan to increase its London operations to 28 B747-400 services per week and subsequently to 35 services per week. The Qantas services proposed in the application are part of a network and other flights in the network will benefit from them. Mounting the additional services and sustaining them over the longer term is important for the financial strength and competitiveness of

Australia's aviation industry, ancillary businesses in Australia and future investment, employment and skills development in the sector.