15 March 2019

Ms Marlene Tucker
Executive Director
International Air Services Commission
GPO Box 630
Canberra ACT 2601

Dear Ms Tucker,

Re: Response to comments on Qantas' application for variation – Hong Kong route

Virgin Australia and the Australian Competition and Consumer Commission (**ACCC**) provided comments on 26 and 28 February 2019 respectively to Qantas Airways Limited's (**Qantas**) application regarding codesharing arrangements with Cathay Pacific (**Cathay**) on the Hong Kong route. Qantas submits the following comments in relation to these submissions.

As outlined in our earlier submission, the application for variation is for Cathay to offer codeshare services only on selected flights operated by Qantas on the Hong Kong route (as outlined in Table 1 below) and only when those flights are sold as part of a through journey ('**the Proposed Variation**').

Table 1: Limited number of flights covered by the Proposed Variation

City-pair sectors (v.v.)	Flight details (Northern Summer 2019)
Sydney-Hong Kong	Hong Kong-Sydney QF118 22:35 – 10:00+1
Melbourne-Hong Kong	Melbourne-Hong Kong QF29 09:40 – 17:20 Hong Kong-Melbourne QF30 20:10 – 07:35+1
Brisbane-Hong Kong	Brisbane-Hong Kong QF97 10:10 – 17:25 Hong Kong-Brisbane QF98 20:15 – 07:00+1

The flights covered by the Proposed Variation are permitted to be sold by Cathay only in conjunction with through journeys to behind and beyond destinations. For clarity, this may include a domestic Australia and/or international sector(s) combined with one of the city-pair sectors (with examples provided in Table 2).

Table 2 (a and b): Potential connecting/through journeys under the Proposed Variation

Zone	Routing
Zone 1	Domestic Australia (all ports) – Sydney/Melbourne/Brisbane (and vice versa)

Qantas Airways Limited, ABN 16 009 661 901, 10 Bourke Road Mascot NSW 2020 Australia
Telephone +61 2 9691 3636, qantas.com

Zone 2	Sydney/Melbourne/Brisbane (selected flights only) – Hong Kong (and vice versa)
Zone 3	Hong Kong – International Destinations (and vice versa)

Potential Connection/Through Journeys	**Can Be Sold To Customers Under Proposed Variation**
Zone 1 + Zone 2 For example, Canberra-Melbourne-Hong Kong Zone 1 + Zone 2 + Zone 3 Albury-Sydney-Hong Kong-Fukuoka	✓
Zone 2 (stand-alone) Sydney-Hong Kong, Melbourne-Hong Kong, Brisbane-Hong Kong	✗
Zone 2 + Zone 3 For example, Brisbane-Hong Kong-Delhi Zone 3 + Zone 2 + Zone 1 Okinawa-Hong Kong-Brisbane-Townsville	✓

The Proposed Variation is confined in scope. It simply enables limited codesharing on *selected* flights on the Zone 2 routes above where an itinerary also includes Zone 1 and/or Zone 3 sector(s). In the absence of approval of the Proposed Variation, such codesharing on Zone 2 routes could not be implemented by Cathay, resulting in reduced consumer choice and benefit.

Public Benefits of the Proposed Variation

As set out in our earlier submission, the Proposed Variation provides a significant number of new or improved connectivity options for consumers, which would not be available absent approval from the International Air Services Commission (**'the Commission'**). We strongly reject Virgin Australia's claim that the Proposed Variation "does not give rise to any additional tourism or trade benefits" (5.27).

Based on published schedules, the ability for Cathay to codeshare on Qantas operated Zone 2 sectors would result in Cathay being able to market a total of 18 new connecting destinations (29 cumulative new connections across all proposed codeshare flights) and 26 improved connecting destinations (40 cumulative improved connections across all proposed codeshare flights) (refer Table 3). This is a clear enhancement of consumer choice and demonstrates the public benefit of the Proposed Variation. Trade and tourism benefits will necessarily flow from the range of new and improved connections.

Table 3: New or improved connectivity to the proposed codeshare services only available under the Proposed Variation

New Connections		
Code	**City**	**Country**
TNA	Jinan	China
CAN	Guangzhou	China
HGH	Hangzhou	China
TAO	Qingdao	China
BLR	Bangalore	India
HYD	Hyderabad	India
MAA	Chennai	India
CCU	Calcutta	India
DEL	Delhi	India

Improved Connections		
Code	**City**	**Country**
YVR	Vancouver	Canada
YYZ	Toronto	Canada
NKG	Nanjing	China
CTU	Chengdu	China
TAO	Qingdao	China
HGH	Hangzhou	China
CGO	Zhengzhou	China
XIY	Xian	China
PVG	Shanghai	China

BOM	Mumbai	India
KNO	Medan	Indonesia
OKA	Okinawa	Japan
KUL	Kuala Lumpur	Malaysia
CMB	Colombo	Sri Lanka
RMQ	Taichung	Taiwan
HKT	Phuket	Thailand
SFO	San Francisco	USA
LAX	Los Angeles	USA

KWL	Guilin	China
HAK	Haikou	China
KMG	Kunming	China
CGK	Jakarta	Indonesia
DPS	Denpasar	Indonesia
CTS	Sapporo	Japan
NRT	Tokyo	Japan
FUK	Fukuoka	Japan
KIX	Osaka	Japan
OKA	Okinawa	Japan
KUL	Kuala Lumpur	Malaysia
TPE	Taipei	Taiwan
KHH	Kaohsiung	Taiwan
BKK	Bangkok	Thailand
SFO	San Francisco	USA
JFK	New York	USA
LAX	Los Angeles	USA

In addition to the new and improved connections and enhancements for customers of both carriers' loyalty programs, the Proposed Variation and broader codeshare arrangements between Qantas and Cathay enhance each carrier's ability to effectively service the Australia to India market.

As stated in Qantas' earlier submission, the ability to offer a maximum range of itineraries beyond Hong Kong to India is particularly critical given distribution changes by Air India and Jet Airways, Qantas' primary partner to service the India market. **[CONFIDENTIAL INFORMATION REDACTED].**

Furthermore, if the Proposed Variation is not approved, Qantas' ability to codeshare on Cathay operated Zone 2 sectors would be under review and subject to further negotiation between the carriers, potentially resulting in even more limited consumer choice. Absent Qantas code on Cathay operated Zone 2 services, attractive connections to 14 codeshare destinations beyond Hong Kong, including Seoul, Delhi, Mumbai, Bangalore and Ho Chi Minh would not be offered by Qantas.

Competitive Impact of the Proposed Variation

Qantas and Cathay consider the Proposed Variation to be fundamentally pro-competitive because of the delivery of clearly increased schedule and itinerary choice for consumers, while preserving and extending the competitive tension between the carriers.

The ACCC indicated that the conduct may make "it easier for Qantas and Cathay to coordinate their price and capacity decisions so as to raise price (or reduce service) for Australia-Hong Kong passengers who connect with a domestic Australia flight and/or a flight between Hong Kong and places in Asia" (page 4). We strongly reject any suggestion that there will be any direct or indirect coordination of price or capacity decisions between Qantas and Cathay under the codeshare (or in any other circumstances). Further to our earlier submission, we reiterate that the Codeshare Agreement between Qantas and Cathay is arms-length and prohibits any form of price, sales, capacity or schedule coordination and we confirm that the arrangement will be implemented in practice in full compliance with all relevant competition laws.

Virgin Australia states the proposed codeshare "…will distort competition…[and] may jeopardise the sustainability of our services." (5.8) The Proposed Variation will not result in any distortion of competition and, as mentioned in Qantas' earlier submission, will instead foster increased competition and innovation including between Qantas and Cathay. In respect of whether Virgin Australia's services will be rendered unsustainable by the Proposed Variation, we would urge the Commission to interrogate such claims very carefully, particularly in circumstances where Virgin Australia's (recently former) CEO John Borghetti has stated that "our premium cabin is just operating beyond any expectation…its seat factors are significantly high and from a corporate point of view, ex-Australia specifically, it's performing extremely well."[1] As set out below, in our view a more realistic impact of the Proposed Variation is the stimulation of a pro-competitive response by Virgin Australia (and other carriers).

In considering the potential impact on competition, we address the four factors which the ACCC believes merit scrutiny (page 5) below:

The importance of connecting passengers for Qantas and Cathay's load factors, yield and capacity planning decisions on Australia-Hong Kong services

The Proposed Variation will not have any adverse impact on the competitive dynamics on point to point routes between Australia and Hong Kong. For Qantas, the Proposed Variation is instead focussed on attracting connecting passengers who are transiting through Hong Kong to beyond destinations.

Qantas, Cathay and Virgin will continue the intense competitive rivalry that has characterised the point to point routes, with all carriers likely to remain focussed on sales and pricing activity to attract and retain point to point traffic. Qantas flights between Australia and Hong Kong are primarily comprised of origin/destination passengers, with connecting traffic representing only 27 per cent of passengers (on average) across the Brisbane/Melbourne/Sydney-Hong Kong services. **[CONFIDENTIAL INFORMATION REDACTED].**

This is expected to be the case for Virgin Australia as well. Only 21 per cent of passengers (on average) travelling on Virgin Australia's services between Australia and Hong Kong are connecting passengers. The remainder of passengers are origin-destination traffic. Therefore, given the provision prohibiting selling of stand-alone point to point routes, the Proposed Variation will have little or no bearing on the passenger base that makes up the clear majority of Virgin Australia's loads (i.e. point to point passengers).

Virgin Australia argues that due to the combined market share of Cathay and Qantas "the exclusion of point-to-point itineraries will not negate the detrimental impact that the proposal will have on competition on the route" (5.4). This is simply not the case. The competitive dynamics on the point to point routes will be unchanged by the Proposed Variation. In any event, given the small proportion of connecting passengers on Virgin Australia's services, and the fact that the Proposed Variation applies to such a limited number of Qantas' operated flights between Australia and Hong Kong, we question the extent to which better enabling through journey selling by Cathay could possibly cause *any* competitive harm to Virgin Australia's services between Australia and Hong Kong, let alone be the cause of any capacity reduction or route exit.

Whether, absent approval from the Commission, Qantas is able to continue to add its code on selected Cathay operated services on the Hong Kong route where passengers are connecting to a Qantas Australian domestic service

As stated above, if the Proposed Variation is not approved, the ability for Qantas to codeshare on Cathay operated Zone 2 sectors would be placed at risk and subject to further discussions between the carriers. To reiterate, it should not be assumed that the counterfactual position in the absence

[1] https://australianaviation.com.au/2019/02/virgin-australia-ceo-questions-proposed-cathay-qantas-codeshare/

of approval of the Proposed Variation would be the implementation of Qantas' code on selected Cathay operated services between Hong Kong and Sydney, Melbourne or Brisbane for the purposes of through journeys.

The extent to which flights have been selected to minimise schedule overlap

As outlined in Qantas' earlier submission, the limited number of flights on the point to point routes that will be covered by the Proposed Variation have been selected to minimise schedule overlap to incentivise each carrier to continue to promote and market their own metal services and maximise connectivity opportunities, improving customer choice.

Under the Proposed Variation, Cathay will codeshare on five of Qantas' eight daily return services between Australia and Hong Kong. Qantas proposes to codeshare on five of Cathay's 18 daily return services between Sydney/Melbourne/Brisbane and Hong Kong.

The extent to which Virgin could or would be likely to disrupt any softening of competition between Qantas and Cathay

Our strong contention is that there will not be any softening of competition between Qantas and Cathay on either the point to point routes or on the selling of any through journeys. If this were to occur, Virgin Australia could and would seize the opportunity to respond and capture traffic lost from any artificial price increase or capacity restriction by either Qantas or Cathay.

Virgin Australia is well placed and incentivised to respond pro-competitively to the Proposed Variation. As Virgin Australia noted, it considers that since it commenced operating between Australia and Hong Kong it has stimulated competition and innovation. This can be reasonably expected to continue where there is evidence of passenger and capacity growth on routes between Australia and Hong Kong and where capacity entitlements for Australian carriers remain available.

As a predominantly "virtual" international airline, Virgin Australia has an extensive range of partnerships with other carriers to extend its network breadth and reach. The Proposed Variation (or any aspect of the codeshare with Cathay) does not in any way inhibit Virgin Australia's ability to utilise (or more extensively utilise) its suite of partnerships as it sees fit to support the commercial performance of its business. Indeed, Virgin Australia has authorisations from the ACCC to cooperate with its shareholder partners directly on the Australia-Hong Kong and Australia-China routes with the Hainan Airlines Group[2], as well as on indirect routes via Singapore under a long-term alliance with the Singapore Airlines Group.

These partnerships and arrangements are reflected in Virgin Australia's selling proposition, although it appears from publicly available information that the arrangements could be more extensively utilised to offer a more compelling proposition – the fact that this has not, or may not occur, is in no way related to the Proposed Variation or any other aspect of Qantas' codeshare with Cathay. For example, on journeys between Australia to India, Vietnam, Sri Lanka and Myanmar, all Virgin Australia airfares are common rated to Singapore Airlines with customers only provided a Singapore Airlines operated option for the entire journey. By contrast, on journeys between Australia and Japan and Korea, Virgin Australia offers only limited options via Hong Kong using its strategic alliance with Hong Kong Airlines. The cheapest options are common rated with, and operated by, Singapore Airlines via Singapore. This clear choice to preference certain partnerships over others may explain the fact that Virgin Australia's services between Australia and Hong Kong predominantly target the point to point passenger base. Accordingly, the fact that Virgin Australia's

[2] Virgin Australia and HNA Group/Hong Kong Airlines/Hong Kong Express have an Alliance Framework Agreement and associated agreements covering the Hong Kong and China routes

share is low on routes beyond Hong Kong more properly reflects its internal strategic direction rather than any exogenous factors.

In addition to Virgin Australia's ability to respond to the Proposed Variation, it should be noted that other carriers with an interest in selling itineraries between Australia and destinations beyond Hong Kong would be well placed to offer a competitive response to Qantas and Cathay. For example, to the codeshare destinations in India (Mumbai, Delhi, Chennai, Kolkata and Bangalore) from Australia, Qantas' share of 8 per cent is far behind that of the dominant carriers Singapore Airlines (27 per cent), Malaysia Airlines (14 per cent) and Thai Airways (13 per cent). Cathay's share to these markets is even smaller at 6 per cent.

Virgin Australia states that "to the extent that the proposed variation jeopardises our ability to retain our current level of capacity on the route, it is likely that the cost of transporting freight between Australia and Hong Kong will increase" (5.30). There is no evidence to support this claim and given the presence of other dedicated freighter operators (such as Emirates, UPS, Polar Air and Fedex) both on the Hong Kong and China routes, in addition to freight carried in the belly space of passenger services, the Proposed Variation will have no impact on the continuation of frequent, reliable and low cost air freight movements.

Virgin Australia's submission references previous decisions made by the Commission on the Papua New Guinea, Japan and South Africa routes (5.15-5.21). These are irrelevant to the Commission's consideration of the Proposed Variation. Each of these previous decisions has been made with respect to a unique set of circumstances that are not transferable to Qantas' application for variation on the Hong Kong route – the primary distinction being that the Proposed Variation is the only one of these codesharing arrangements which excludes the point to point routes.

Finally, the ACCC's submission suggests that the Commission may wish to closely monitor the route should it approve the Proposed Variation. While Qantas acknowledges the ability of the Commission and ACCC to continue to monitor and re-assess the impact of the Proposed Variation over time, it does not support the imposition of conditions that restrict the commercial and operational flexibility of codeshare arrangements, particularly given the limited scope of the current proposal and the significant competitive intensity that will remain on all relevant routes.

Yours sincerely,

Andrew Parker
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