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28 March 2019

Ms Marlene Tucker
Executive Director
International Air Services Commission
PO Box 630
CANBERRA ACT 2601

Dear Ms/Tucker

Qantas Airways' application for variation - Hong Kong route

I refer to my previous correspondence regarding the abovementioned subject, as well as the various submissions and correspondence lodged with the International Air Services Commission (the Commission) by Qantas Airways (Qantas) and the Australian Competition and Consumer Commission (ACCC) in relation to this matter.

In response to Qantas' letter to the Commission of 15 March 2019, Virgin Australia wishes to highlight a number of salient points in reinforcing and further substantiating the arguments outlined in our submission of 26 February 2019.

Public benefits claimed by Qantas

As noted in our previous submission, the Commission must assess whether Qantas' application will be of benefit to the public when assessed against each of the relevant criteria in paragraph 9 of the *International Air Services Commission Policy Statement 2018* (Minister's Policy Statement).

Presumably in relation to paragraph 9 (c) of the Minister's Policy Statement, Qantas suggests that the proposed cooperation with Cathay Pacific will "provide a significant number of new or improved connectivity options for consumers, which would not be available absent approval from the International Air Services Commission". This statement is inaccurate.

For example, based on an example in Qantas' own submission, it is clear that a Canberra-Melbourne-Melbourne-Hong Kong itinerary operated exclusively by Qantas, but marketed by Cathay Pacific, would be in scope for the proposed code share. This example does not give a passenger a new schedule option, as these flights are currently available for sale by Qantas. Accordingly, Qantas' application delivers no public benefit in this regard.

¹ Qantas' letter to the Commission dated 15 March 2019, p 2.



Cathay Pacific's ability to market domestic services operated by Qantas in connection with the flights it operates between Hong Kong and each of Brisbane, Sydney and Melbourne is not dependant on approval of the proposed code share. In fact, Cathay Pacific already offers code share services on 27 domestic routes operated by Qantas. Increasing domestic code share options, which would deliver incremental passenger choice, is not contingent on Cathay Pacific offering code share services on Qantas' flights between Australia and Hong Kong.

It is suggested by Qantas that the proposed code share will give Cathay Pacific the ability 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)" and that these new connections are "only available under the Proposed Variation". Attached as **Appendix 1** to this letter is a series of screenshots from Cathay Pacific's website which show that each of the 18 destinations claimed as "new connecting destinations" is already available as a connection to flights operated between the proposed Australian code share ports (Brisbane, Sydney and Melbourne) and Hong Kong by Cathay Pacific. It is therefore difficult to understand how the proposed code share will provide passengers with access to 18 new destinations.

Qantas cites the need to offer "a maximum range of itineraries beyond Hong Kong to India" as critical given the changes that Air India and Jet Airways have made to their distribution platforms, and as further justification for its application. Once again, we would highlight that Qantas' ability to implement code share services on flights operated by Cathay Pacific to destinations in India is not dependant on Cathay Pacific offering code share services on flights operated by Qantas between Australia and Hong Kong. Accordingly, suggestions that the approval of Qantas' application itself has the potential to drive increased inbound tourism from India would seem to be overstated.

Qantas states that "...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." The extent of the commercial cooperation between Qantas and Cathay Pacific on routes not encompassed by the legislative framework of the Commission is irrelevant to the current application. Therefore, any suggestion that Qantas' application and its ability to implement broader code share cooperation with Cathay Pacific are interdependent should be disregarded by the Commission in its assessment of the application's public benefit.

In relation to Qantas' claims that the application will provide passengers with improved connections on several routes, Virgin Australia would encourage the Commission to carefully assess whether (in some cases) a marginal journey time improvement (e.g. 50 minutes as shown in Hong Kong-Sapporo example below) will actually deliver any meaningful benefits for Australian consumers, tourism or

² Ibid.

³ Ibid, p 3.

⁴ Ibid.



trade. This is particularly relevant given the claims made by Qantas that the code share will allow Cathay Pacific to market 18 new destinations.

Overall, the public benefits claimed by Qantas in its application are marginal. Certainly, they do not outweigh the potential negative impact that the proposed code share will have on competition on the route, as outlined further below.

Impact on competitive dynamics

As highlighted in our earlier submissions, Qantas and Cathay Pacific currently dominate the Hong Kong route, holding a combined frequency, capacity and passenger share of 89%, 90% and 92% respectively. The extent of the market power held by Qantas and Cathay Pacific cannot be overlooked in assessing the merits of Qantas' application. Allowing any further concentration of this market power will cement their dominance on the route, at the expense of Virgin Australia and potential new entrants. Inevitably, this will have negative implications for the travelling public, tourism and trade. Furthermore, it would inhibit the realisation of the benefits that the Australian Government is seeking to deliver through its new Free Trade Agreement with Hong Kong. Such an outcome would be wholly insistent with the object of the *International Air Services Commission Act 1992* (Cth) (the Act).

Virgin Australia firmly rejects Qantas' assertion that its application will not have any adverse impact on the competitive dynamics on point-to-point routes between Australia and Hong Kong. This simplistic view is incorrect and glosses over the complexities of route profitability, as explained directly below.

All airlines carry a combination of traffic on their services on the route, comprised of local point-to-point passengers, behind connections from domestic Australia (and some international connections), connections beyond Hong Kong and connections that incorporate both behind and beyond journeys, with route performance driven by all four types of traffic. It is logical to expect that approval of Qantas' application will lead to an increase in the volume of connecting traffic (due to sales by Cathay Pacific), which would result in higher passenger load factors for its flights between Australia and Hong Kong. With this increased load, Qantas will have a greater ability to adopt different strategies on pricing and inventory management in both the local point-to-point markets, as well as behind connections on domestic Australian routes. To suggest otherwise would be completely contrary to established revenue management practices.

In addition, Australian domestic traffic which connects with sectors between Brisbane, Sydney, Melbourne and Hong Kong (i.e. a journey consisting of a Zone 1 and Zone 2 sector in reference to Table 3 in Qantas' letter of 15 March 2019) is in scope for this application. For Virgin Australia, passenger volumes on domestic connections are a key driver of the commercial performance of our

⁵ Bureau of Infrastructure, Transport and Regional Economics, International Airline Activity, 12 months ending November 2018.



services on the Hong Kong route. The proposed code share will enable Cathay Pacific to drive increased volumes of passengers onto Qantas' domestic connections (noting none of these would be new from a consumer point of view, with all currently marketed by Qantas), placing Virgin Australia at a competitive disadvantage in the Australia-Hong Kong market vis-à-vis our two competitors — which already collectively carry more than 90% of all passengers on the route.

The exclusion of point-to-point itineraries from Qantas' application does not alter the fact that <u>it still encompasses a code share on overlapping routes</u>. This entails potentially significant detrimental impacts on competition, as canvassed in our earlier submissions and consistent with the rationale underpinning the previous decisions of the Commission on the Papua New Guinea, Japan and South Africa routes.

While Qantas states that its code share agreement will prohibit any form of schedule coordination, by nature of the timings of the code share services chosen, both Qantas and Cathay Pacific in effect receive the benefits of schedule coordination. This is due to the fact that both carriers would have a reduced incentive to re-time their flights to improve connectivity, to the extent that an improved connection is achieved through a code share on the other carrier's service. This is directly relevant to the ACCC's observations in its letters of 28 February 2019 and 26 March 2019 regarding the scope for Qantas' application to result in a softening of competition on the route.

For example, in July 2019 Cathay Pacific will operate a flight on a Friday on the Sapporo-Hong Kong sector at the timings of 1635/2100 (CX581). This service currently has a connection time of 2:55 onto Cathay Pacific's Hong Kong-Sydney service (CX101) at 2355/1050. If Cathay Pacific wished to reduce the connection time between these services, it could either re-time CX101 to an earlier departure at the expense of breaking connections onto CX101 from places such as Narita (2225 arrival on CX505) or re-time its CX161 on the Hong Kong-Sydney route from 2130/0850 to a later departure, and elongate connections from cities such as Shanghai (2030 arrival on CX369). With the proposed codeshare, Cathay Pacific no longer needs to make the trade-off for these connections as it can offer a 1:35 connection onto a Qantas service at 2235/1000 (QF118) and shorten the overall journey time by 50 minutes.

Benefits for Cathay Pacific

In Virgin Australia's view, it seems that Cathay Pacific would stand to receive the most significant commercial benefit from approval of Qantas' application. As noted in our previous submission, the proposed code share would give Cathay Pacific access to additional frequencies to the Australian major international gateways. This obviates the need for it to secure additional capacity under the Australia-Hong Kong air services arrangements to support the expansion of its own flights. It also provides a disincentive for Cathay Pacific to introduce new or expanded services to Australia's non-major international gateways. If the capacity entitlement under the Australia-Hong Kong bilateral is not increased, it will not be possible for other Hong Kong carriers to commence services to Australia's major international gateways in competition with Cathay Pacific. It is not clear to Virgin Australia how these outcomes would align with the object of the Act or the paragraph 9 criteria of the Minister's



Policy Statement, particularly in relation to the maintenance of Australian carriers capable of competing effectively with airlines of foreign countries.

Commercial performance of Virgin Australia's Hong Kong services

Qantas refers to remarks made by our former Chief Executive Officer and Managing Director Mr John Borghetti regarding our load factors on the Hong Kong route in our Business Class cabin. These remarks were accurate. It is also relevant to note that we offer a smaller number of seats in our Business Class cabin, compared to Qantas and Cathay Pacific.

As stated in our earlier submission and according to public sources, the overall load factor for Virgin Australia's services on the route was 65.8% in the 12 months ending November 2018, compared to the 80.5% and 82.1% recorded by Qantas and Cathay Pacific respectively over the same period.

[CONFIDENTIAL MATERIAL REDACTED]

Weighing up the public benefit

In reaching a decision on Qantas' application, the Commission will need to determine if the extremely limited public benefits associated with the code share proposal outweigh its corresponding potential detriment to competition, tourism and trade. From a practical perspective, Virgin Australia would encourage the Commission to consider whether a reasonable member of the travelling public, or an Australian exporter, would be willing to risk the Hong Kong route returning to a market dominated by two carriers in a duopoly, in exchange for gaining the ability to access marginal improvements in flight connection times and increased frequent flyer points.

It is also important to note that the majority of passengers travelling on the Hong Kong route are travelling on point-to-point itineraries and it is therefore logical to expect that these travellers would consider that the benefits of robust competition from three or more carriers, in terms of lower airfares and increased service options, are more valuable than the claimed benefits of Qantas' proposal. As noted above, however, the ability of all airlines on the route to attract connecting traffic is relevant to the overall viability of their services.

Virgin Australia would be pleased to meet with the Commission at its convenience to expand on any of the material provided in our submissions to this case.

Yours sincerely

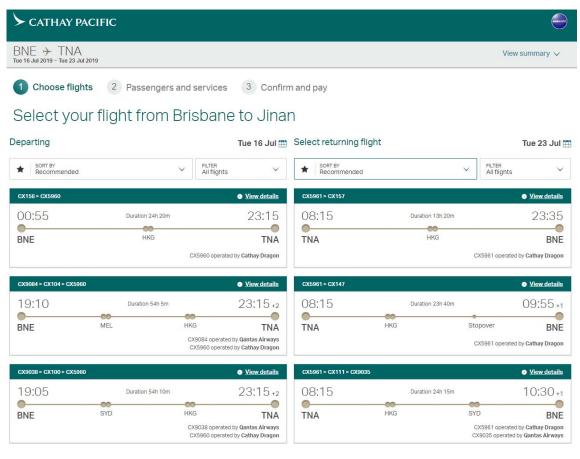
Lee-Anne Tomkins

Head of Government and International Relations

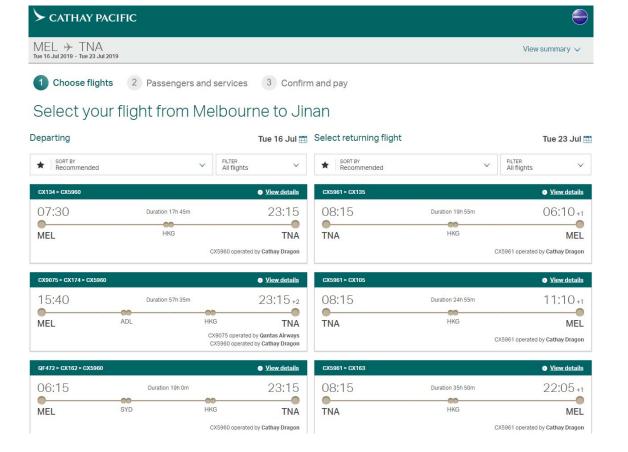
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APPENDIX 1

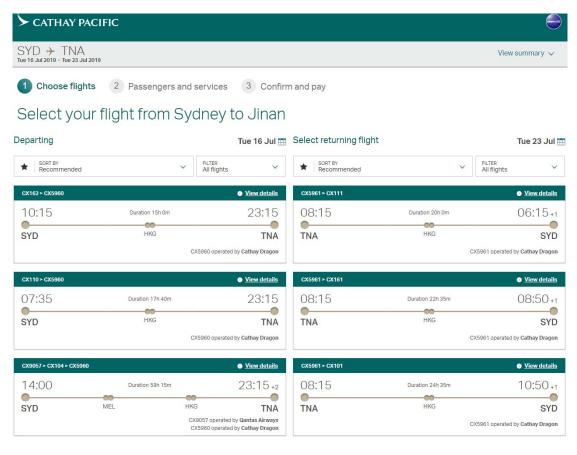
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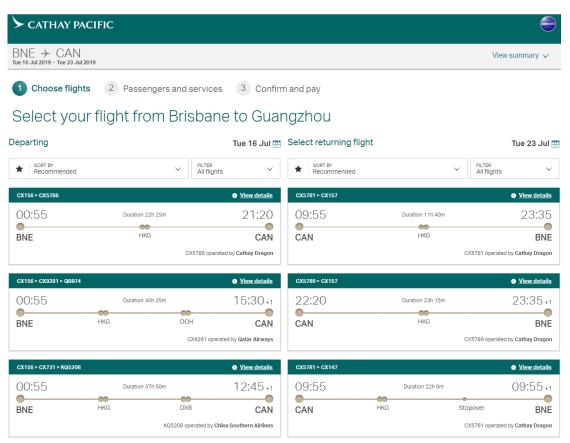
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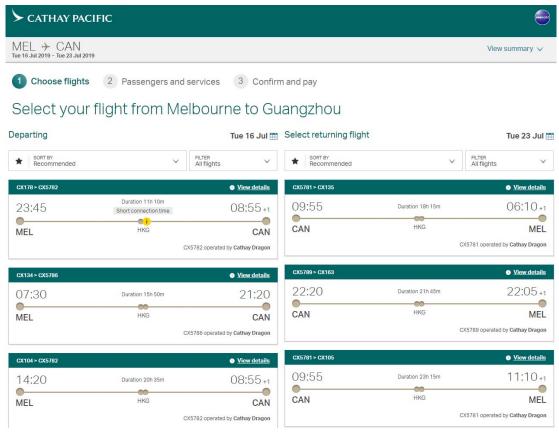
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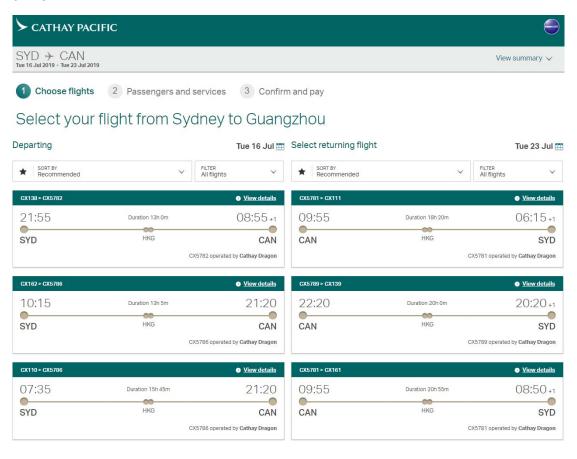
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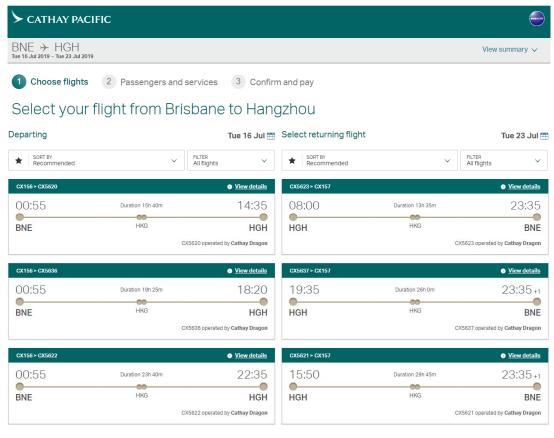
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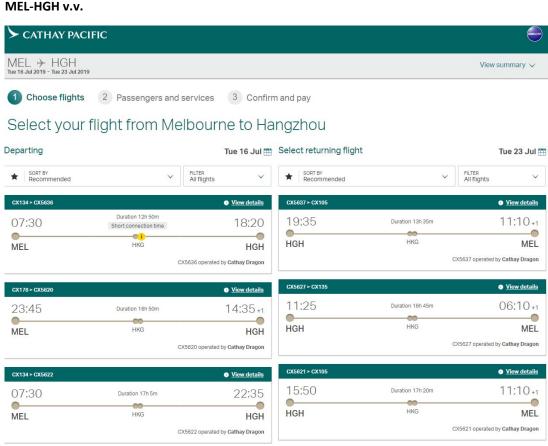
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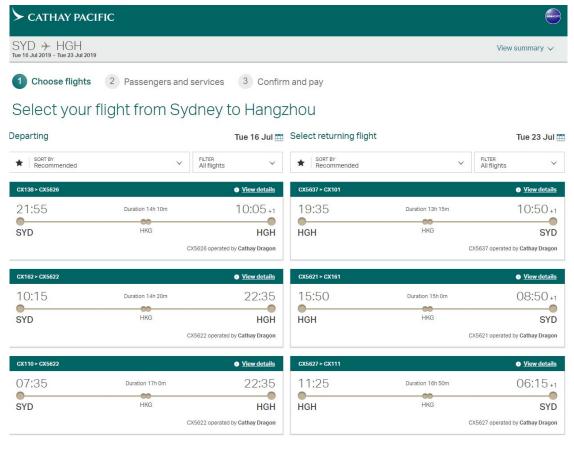
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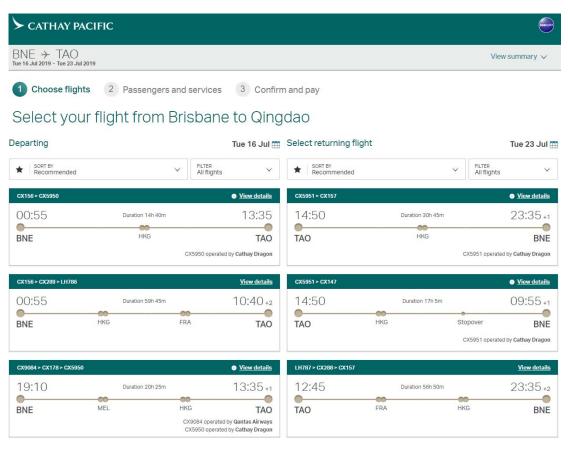
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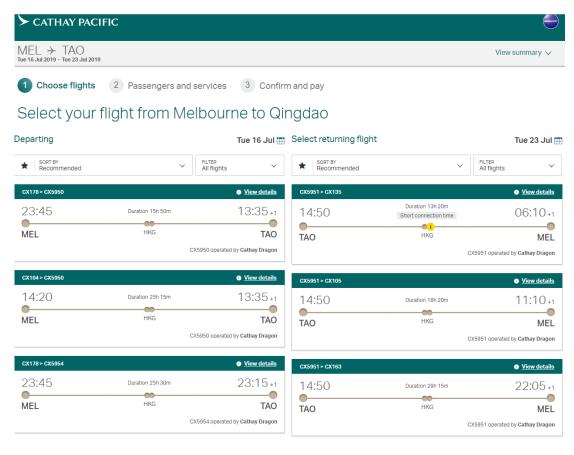
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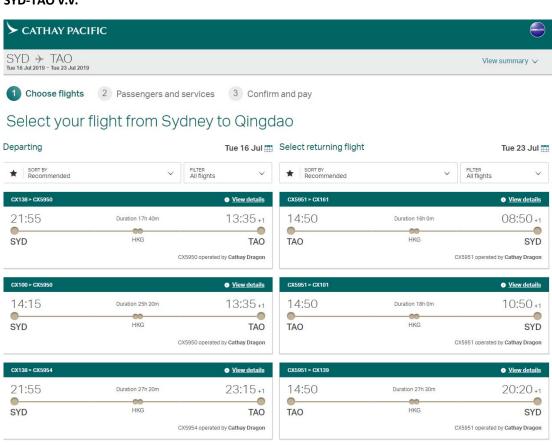
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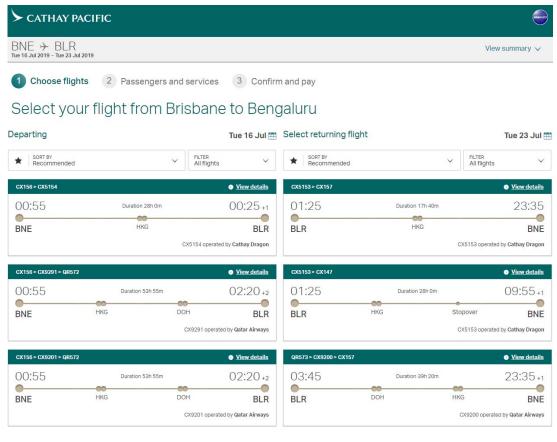
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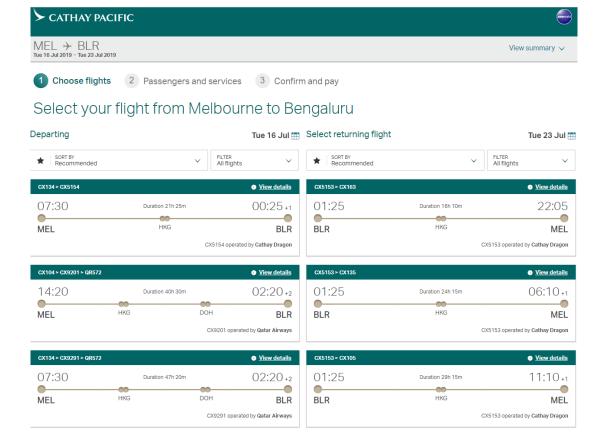
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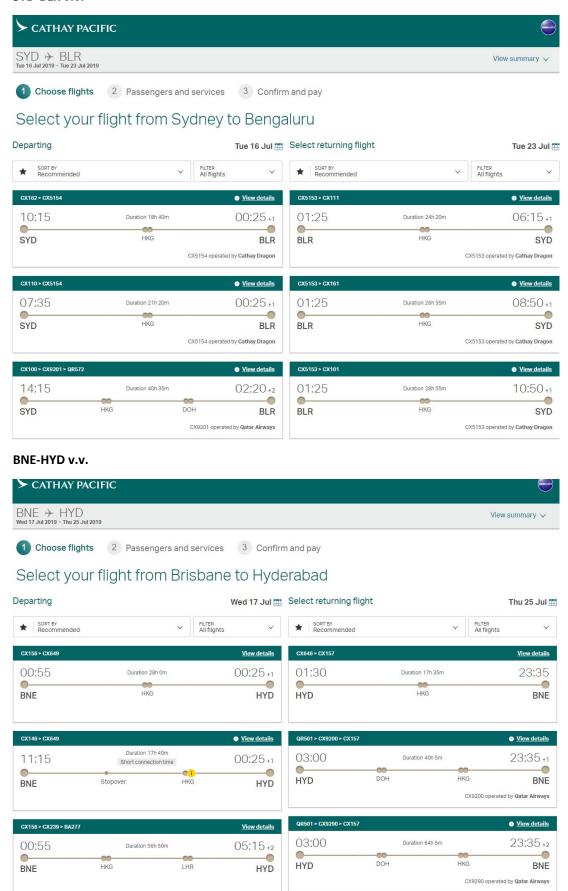
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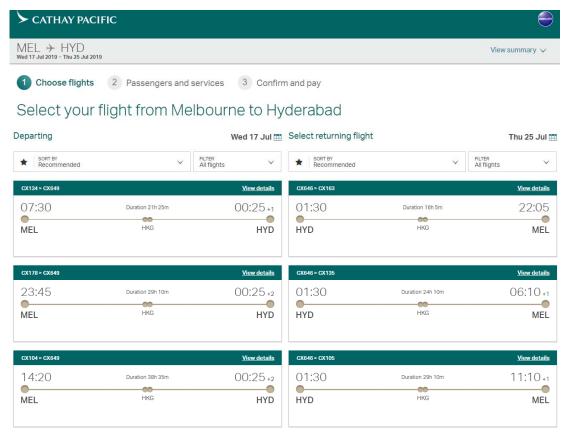
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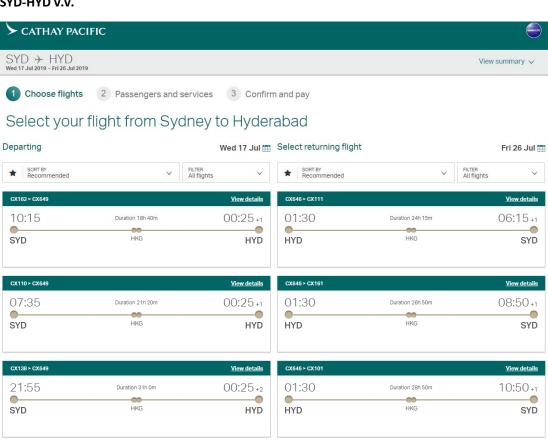
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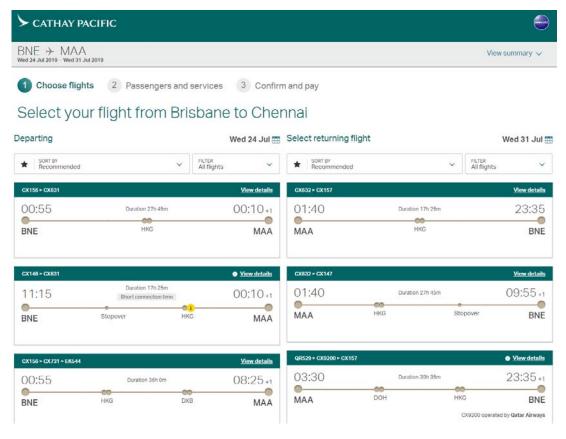
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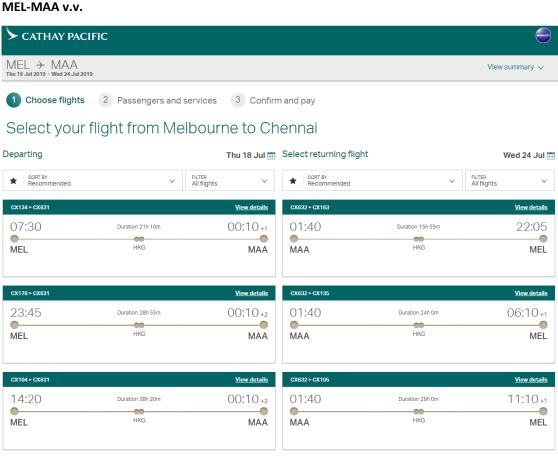


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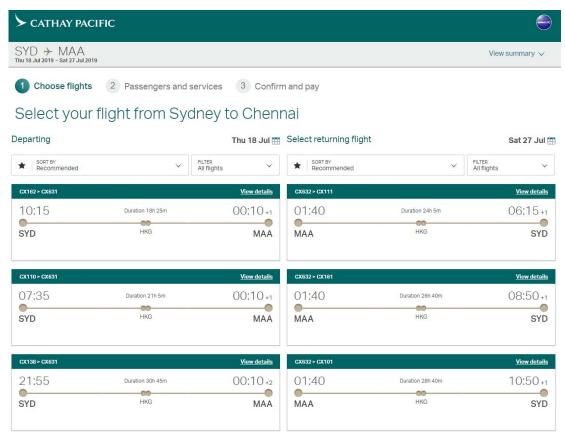


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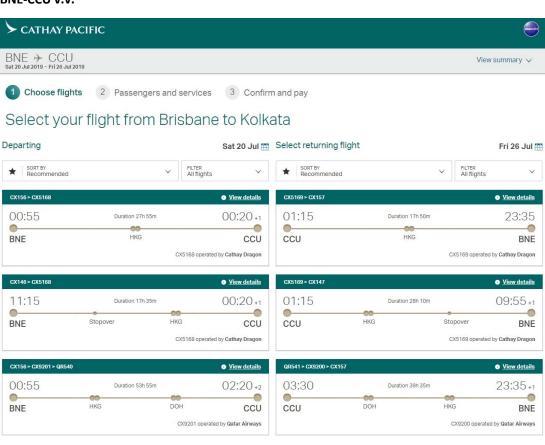




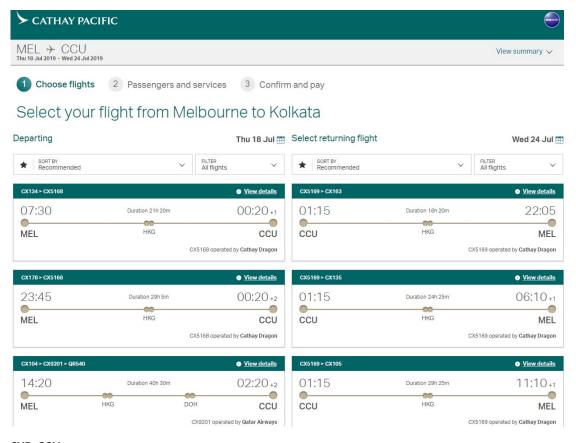
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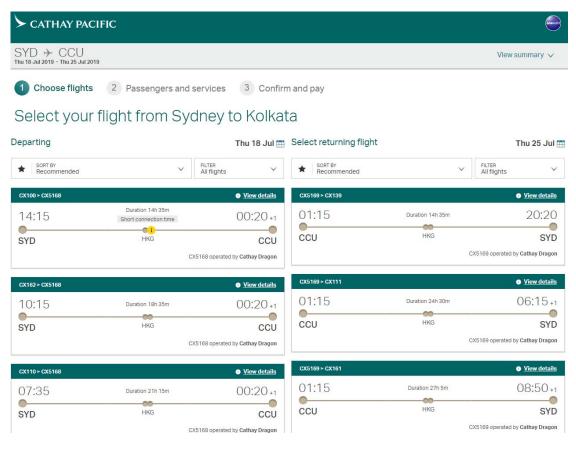
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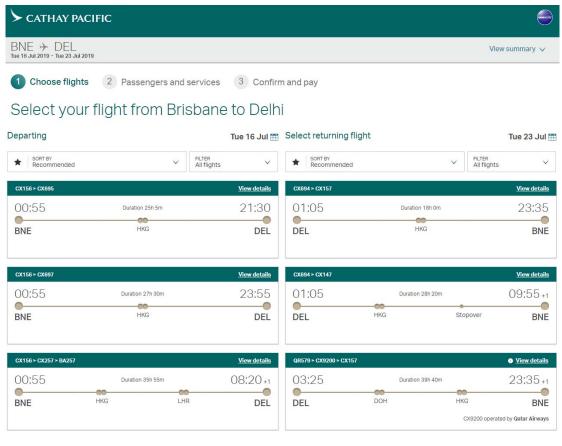
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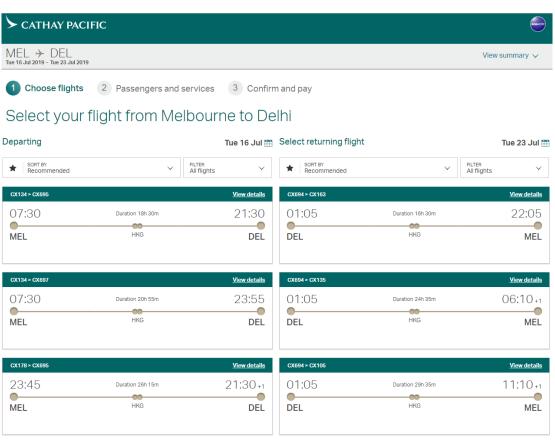
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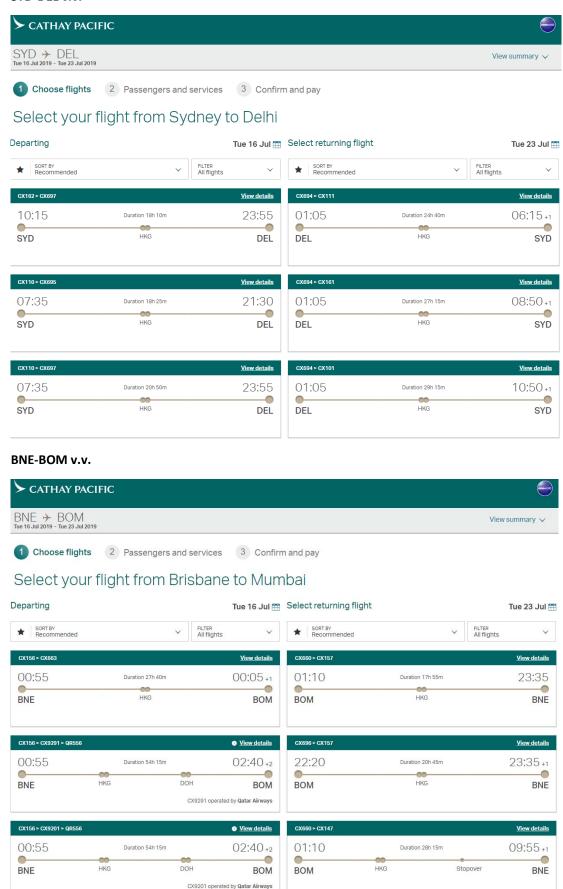
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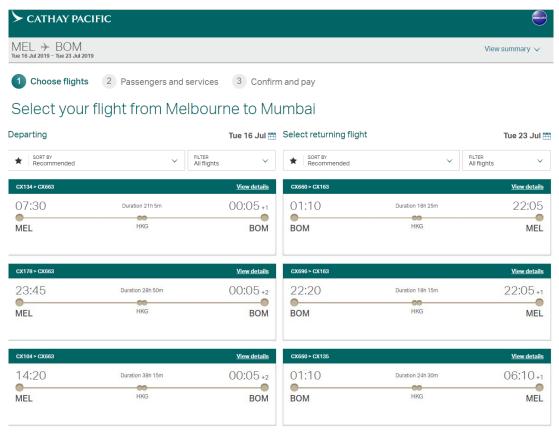
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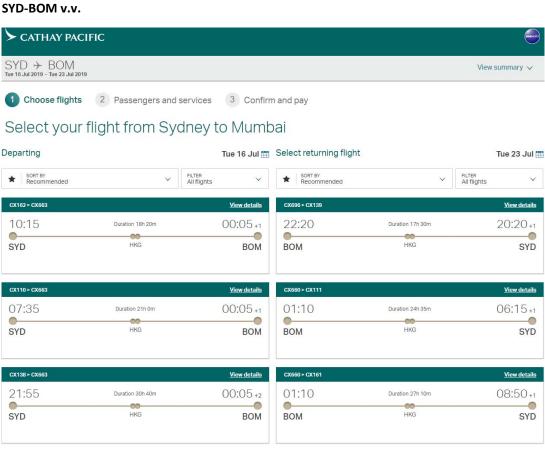


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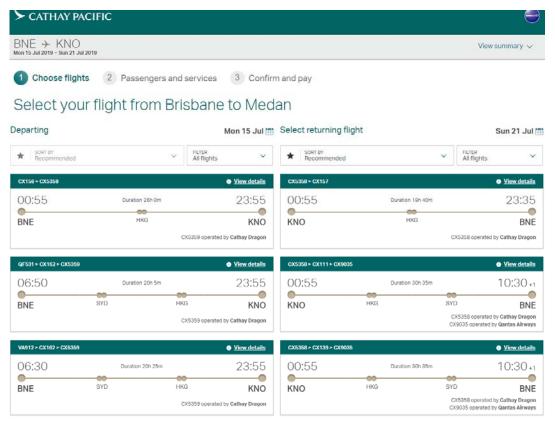


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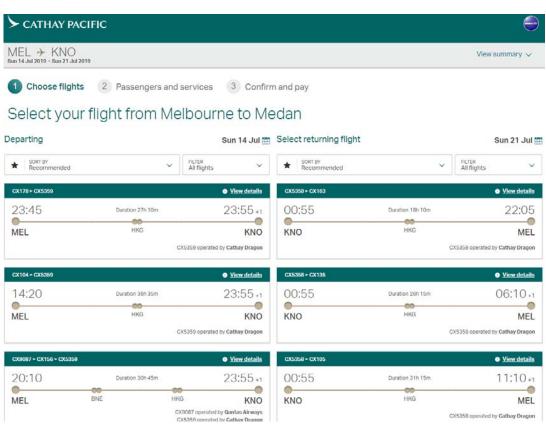




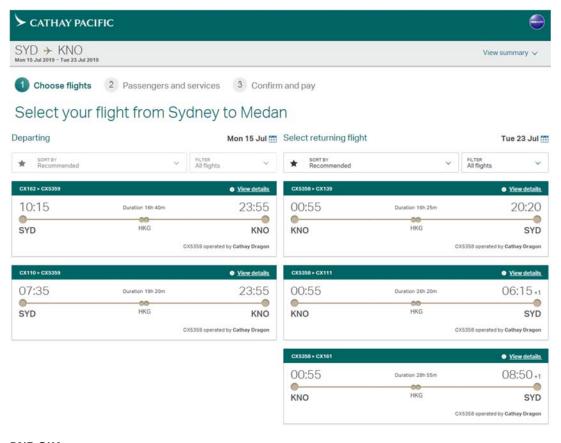
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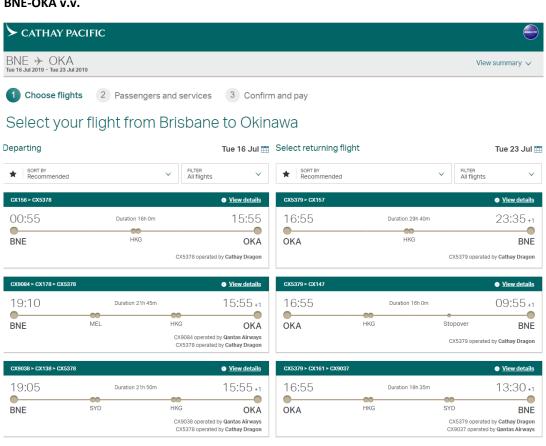
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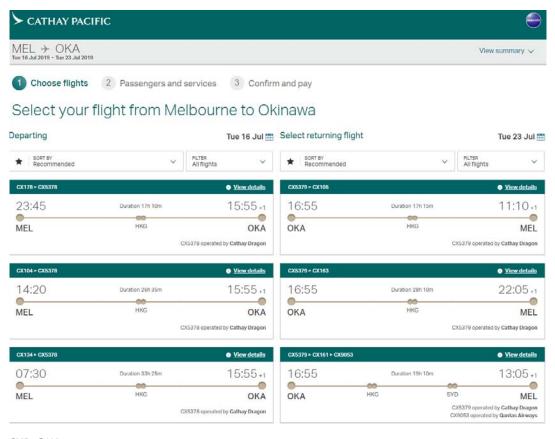
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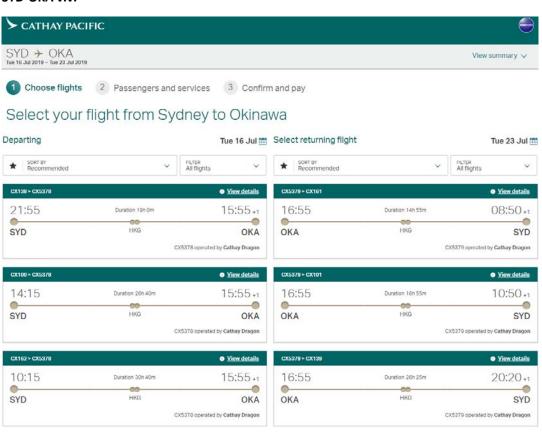
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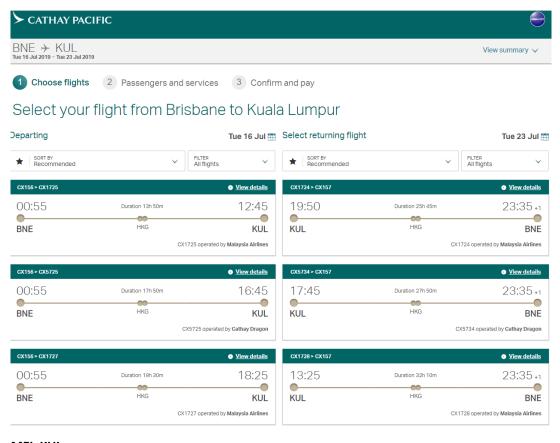
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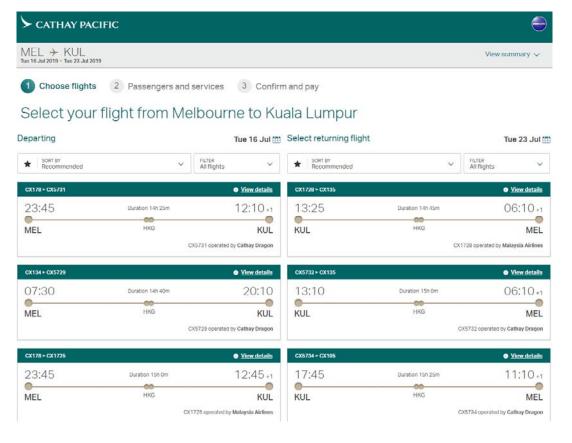
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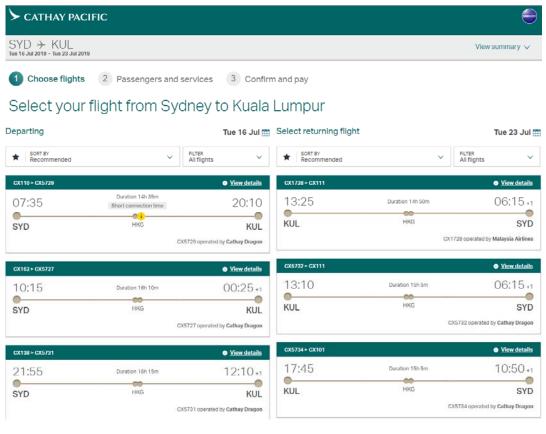
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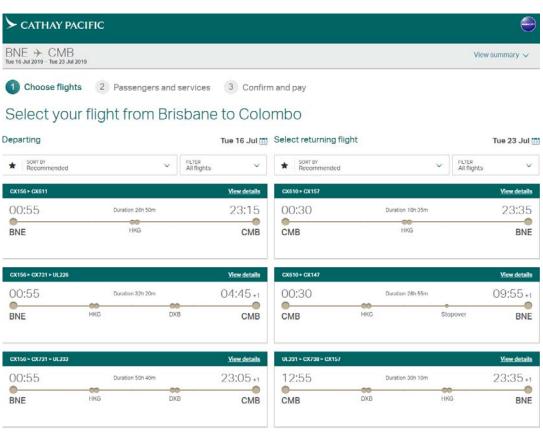
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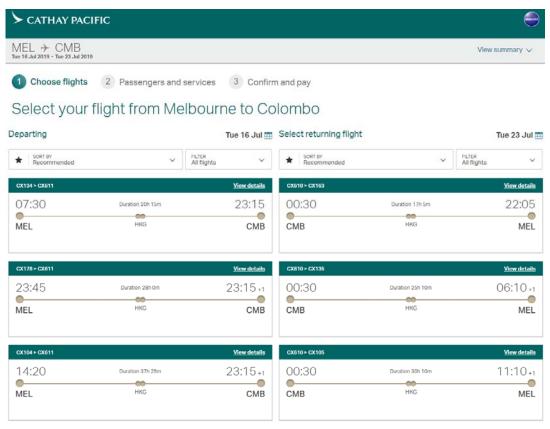
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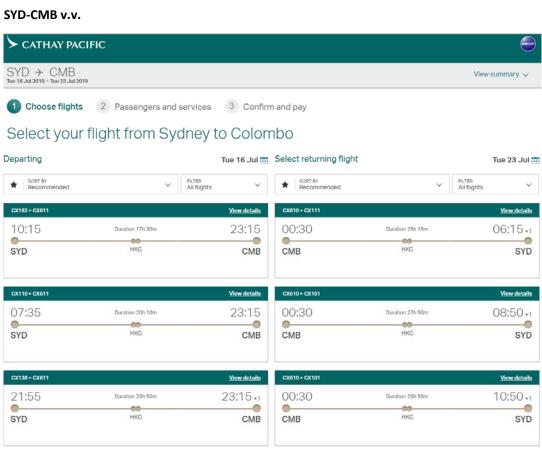


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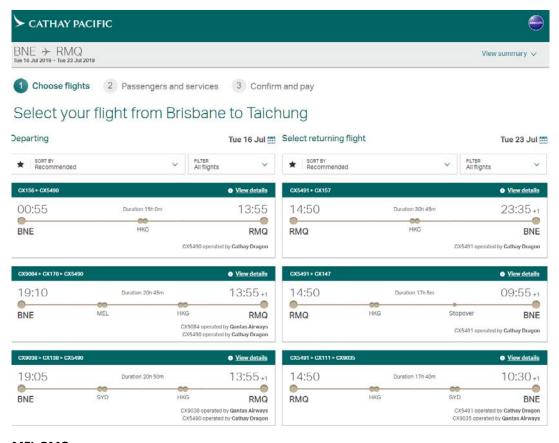


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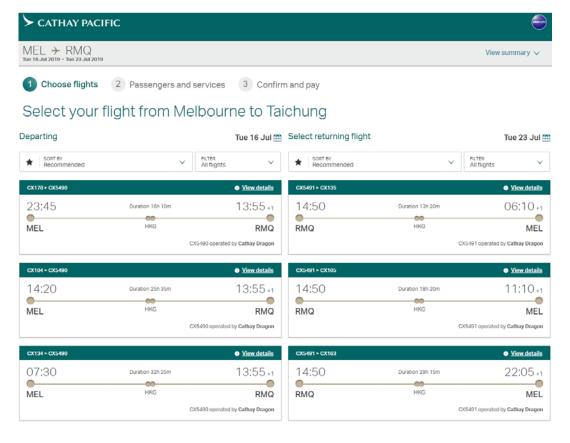




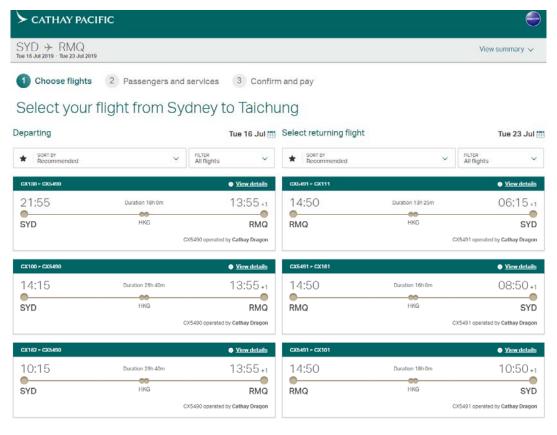
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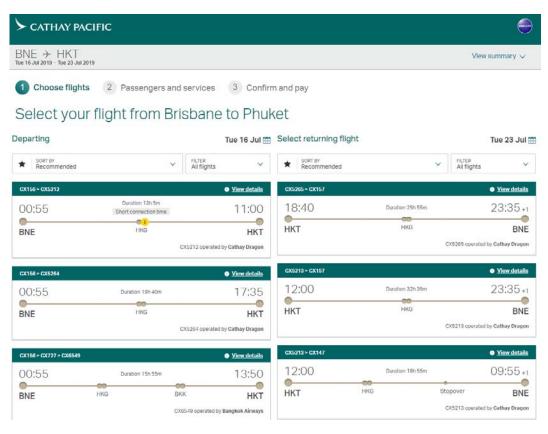
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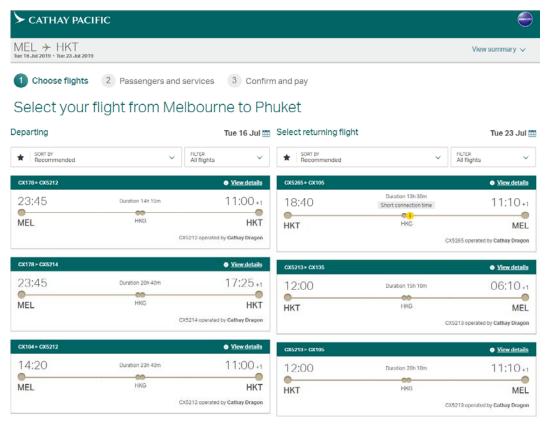
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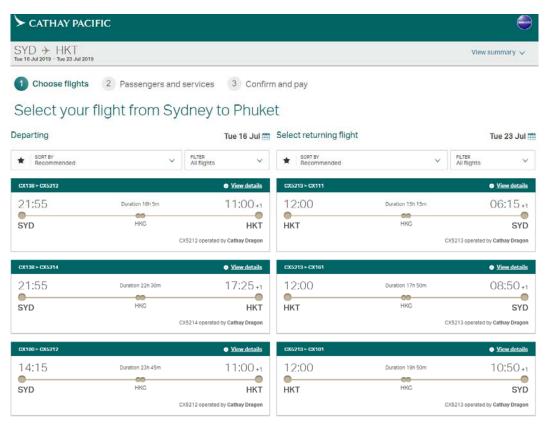
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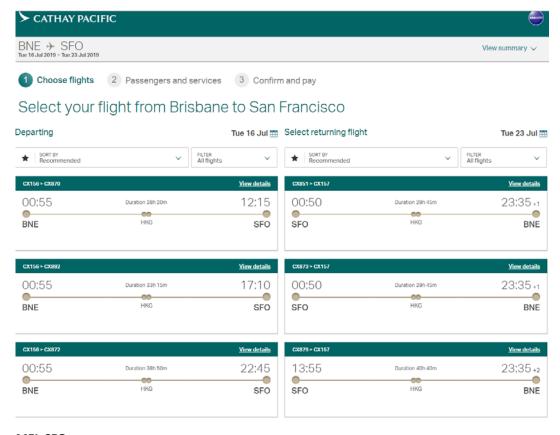
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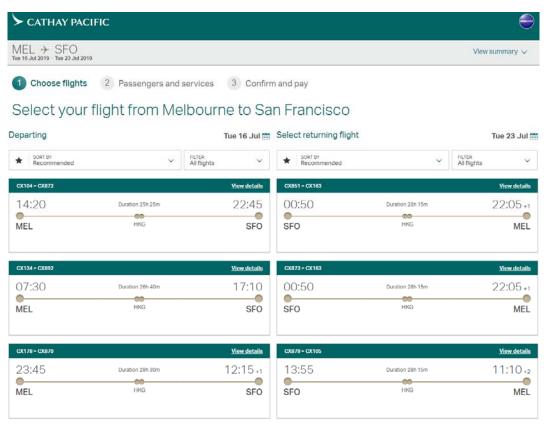
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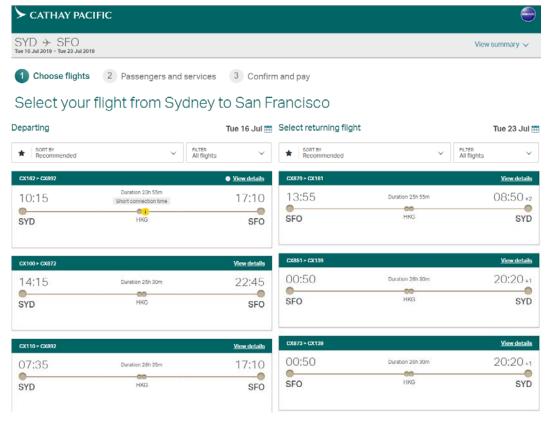
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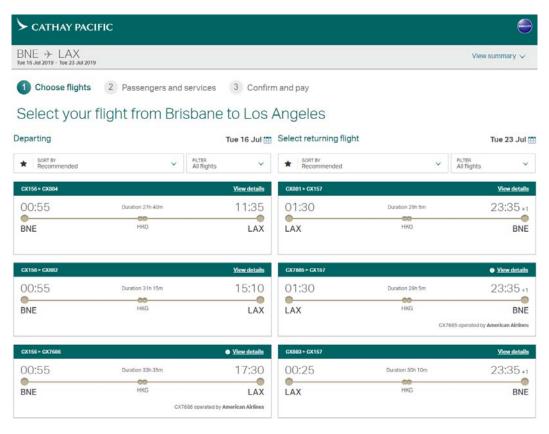
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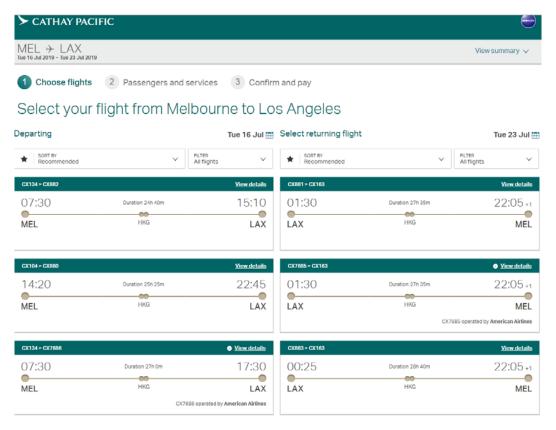
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BNE-LAX v.v.



MEL-LAX v.v.



SYD-LAX v.v.

