



14 June 2019

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

Dear Ms Tucker, *Marlene*

**Submission in Response to Draft Decision [2019] IASC 204d**

Qantas Airways Limited (**Qantas**) appreciates the opportunity to file this submission in response to the International Air Services Commission's (the **Commission**) Draft Decision [2019] IASC 204d under section 25 of the *International Air Services Act 1992 (Cth)* (**the Act**) regarding Qantas' application for variation (**Draft Decision**).

Qantas strongly believes the proposal for Cathay Pacific (**Cathay**) to code share on selected Qantas flights to and from Hong Kong (**Proposed Codeshare**) is a pro-competitive proposition for consumers and satisfies the relevant test for approval under the Act. In Qantas' view, the Draft Decision has reached inappropriate conclusions about likely competitive effects of the Proposed Codeshare and fails to give proper weight to the tangible and immediate consumer benefits that the Proposed Codeshare would deliver, or those that are likely to be unwound in the event the Proposed Codeshare is not approved.

Accordingly, the Draft Decision should be reversed and the Proposed Codeshare should be approved in accordance with the policy objectives that the Act and the IASC Policy Statement 2018 dated 18 March 2018 (**the Policy Statement**) seek to achieve.

If you have any questions or would like to discuss the above, please do not hesitate to contact me.

Yours sincerely,

**Andrew Parker**  
Group Executive, Government, Industry, International, Sustainability



## 1. The Commission Has Reached Inappropriate Conclusions About Competitive Effects

There are substantive flaws in the Commission's assessment of likely competitive effects of the Proposed Codeshare.

Qantas does not agree with the approach that the Commission has adopted to assess competitive effects. Specifically, Qantas objects to the Draft Decision placing too much emphasis on the point to point routes between Australian gateways and Hong Kong – referred to as (a) in paragraph 5.7 of the Draft Decision in the assessment of competitive effects. As identified in Qantas' submissions of 11 February and 15 March 2019, those point to point journeys cannot be sold in isolation under the Proposed Codeshare – they can only be sold as part of a through journey. The Proposed Codeshare is designed to maximise and facilitate through journeys and any potential spillover impact on point to point routes would be marginal or non-existent in practice, yet the Commission has almost entirely focussed on Australia-Hong Kong routes in its assessment.

In adopting such a narrow focus, the Draft Decision does not properly assess the genuine competitive constraints imposed on Qantas and Cathay (nor, as explained below, the public benefits that would be delivered to passengers wishing to travel from Australia to destinations beyond Hong Kong). Paragraph 5.30 of the Draft Decision acknowledges the role of Hong Kong as a regional hub. However, the analysis has not given sufficient weight to the fact that other major carriers, who actively compete to sell itineraries between Australia and destinations beyond Hong Kong, would be well placed to respond to any hypothetical price rise or capacity restriction by Qantas or Cathay with respect to connecting passengers.

Competition from third country carriers on itineraries that will be offered under the Proposed Codeshare is extensive, as Qantas has previously identified in its submission of 15 March 2019 (see page 6). For example, passengers have a number of options to fly between Australia and India with one-stop itineraries via hubs such as Singapore, Malaysia, Thailand and Hong Kong. Many third country carriers operate to and from those hubs to multiple points in Australia with high frequencies. These carriers already provide a strong competitive constraint on Qantas and Cathay. This was highlighted in Qantas' submission of 15 March 2019, where Qantas and Cathay's combined market share on services between Australia and India is less than Singapore Airlines (which operates almost 140 weekly frequencies between Australia and Singapore and with whom Virgin Australia has an authorised strategic alliance) (see page 6).

In addition to placing insufficient weight on the broader 'behind/beyond' nature of the Proposed Codeshare, the Draft Decision appears to adopt the view that the point to point Australia-Hong Kong routes are not currently characterised by healthy competition and this will be exacerbated by the Proposed Codeshare. Evidence shows this is not the case. There is currently intense competition between the direct operators Qantas, Cathay and Virgin Australia. The market is growing in terms of passenger volumes and capacity, airfares have been on a downward trend for many years and all operating carriers are investing in improvements in product and service quality. These facts have been reiterated recently by Virgin Australia and Virgin Atlantic in their application to the ACCC for authorisation of their proposed alliance dated 3 June 2019 (**Virgin Australia/Virgin Atlantic Authorisation Application**) (see pages 19, 26).

A re-examination of the Proposed Codeshare's impact on competition relative to an appropriate counterfactual is warranted. The Commission's view that the Proposed Codeshare will lead to anti-competitive effects, such as "increases to airfares" on point to point routes (paragraph 5.49(d) and

5.34 of the Draft Decision), ignores the commercial realities of this competitive market and potentially mis-applies paragraph 9 (c) of the Policy Statement:

*the likely impact on consumers of the proposed allocation, including on costs of airfares, customer choice, product differentiation, stimulation of innovation by incumbent carriers, and frequency of service.*

In undertaking a re-examination it is important to bear in mind that competition is generally understood to be a dynamic, rather than static, process that expresses itself in rivalrous market behaviour. Moreover:

- there are no reasonable grounds to assert that market sharing or any other type of collusive practice will occur as a result of the Proposed Codeshare; and
- the Proposed Codeshare is an arms-length arrangement without antitrust immunity, unlike immunised alliances such as Virgin Australia's existing relationships (Virgin Australia / Singapore Airlines and Virgin Australia / HNA and its subsidiary Hong Kong Airlines) and that sought in the Virgin Australia / Virgin Atlantic Authorisation Application.

Against this background, Qantas does not agree with the Commission's assumption that increased loads generated from greater connecting traffic on Australia-Hong Kong routes would lead to less discounting by Qantas and Cathay to the detriment of price sensitive travellers (as stated in paragraph 5.34 of the Draft Decision). Refraining from offering competitive pricing is simply not possible in an intensely competitive environment. Even in the context of the Proposed Codeshare, customers will continue to have the ability to switch between three separate carriers operating direct point to point services (and independently pricing and marketing those services), or to other routings, in response to any attempt by a particular operator to artificially increase price.

Similarly, we dispute the Commission's claim (paragraph 5.34 of the Draft Decision) that if the Proposed Codeshare was implemented, Virgin Australia would necessarily have less need to engage in vigorous price competition to generate traffic – thereby making it *'less likely that Australian carriers can effectively compete on the route in question'* (paragraph 5.37 of the Draft Decision). Again, this point lacks any substantiating evidence. If there was an attempt under the Proposed Codeshare by Qantas or Cathay to increase price beyond the competitive level, it is equally possible that Virgin Australia would be uniquely placed to continue vigorous price competition and win an increasing share of price-sensitive passengers, particularly given that it appears Virgin Australia services are not currently capacity constrained, nor are there any structural barriers to expansion facing Virgin Australia.

The Commission also considers that the Proposed Codeshare has *'the potential'* to reduce the direct competitive intensity between Qantas and Cathay (paragraph 5.42 of the Draft Decision). It appears the basis for this conclusion is a view that the Proposed Codeshare reduces the incentives of both carriers to re-time their flights to improve connectivity (see the reference to "schedule coordination" at paragraph 5.32 of the Draft Decision). This is another speculative conclusion without reasonable grounds and, like the Commission's conclusion on price increases, does not consider the broader competitive environment including constraints imposed by third party carriers.

Finally, Qantas also challenges the Commission's conclusion in paragraph 5.49(b) of the Draft Decision that the Proposed Codeshare would make it more difficult for new entrants to operate on the Australia-Hong Kong route. There are no reasonable grounds for this assertion, particularly in circumstances where the Proposed Codeshare is essentially a limited extension of an existing relationship that is expected to generate more rather than less demand on the route.

The Commission points to the fact that Cathay has already been granted all the capacity entitlements that are available to a Hong Kong carrier which makes it *'especially difficult for another Hong Kong carrier to operate commercially sustainable operations as it will not be able to operate to the major Australian gateways'* (paragraph 5.49(b) of the Draft Decision). To the extent this is a barrier to new entry by a Hong Kong based carrier, it is a function of the capacity entitlements rather than any likely effect of the Proposed Codeshare. If the Commission's view is that the Proposed Codeshare *itself* would raise entry or expansion barriers and thereby has an anti-competitive effect, we would welcome substantiation of how this detriment would materialise in practice – particularly when even Virgin Australia recognises that *'there is little prospect of further new entry in the short to medium term'* (page 21; see also page 26 of the Virgin Australia/Virgin Atlantic Application for Authorisation).

## **2. The Proposed Codeshare Will Not Lead To Virgin Australia Becoming a Less Effective Competitor**

Virgin Australia is an effective and vigorous competitor on the Australia-Hong Kong route. The Commission agrees that this is the case (paragraph 5.37 of the Draft Decision) yet concludes there is a real prospect that the Proposed Codeshare will undermine Virgin Australia's effectiveness and even create an environment which would drive that carrier from the route altogether.

Qantas rejects the contention that the relatively limited expansion of an existing codeshare agreement could possibly have such detrimental impacts as claimed. Any claims that the Proposed Conduct could so drastically influence market structure and cause another airline to possibly exit a market must be fully tested and substantiated.

Virgin Australia claims that the Proposed Codeshare would *'significantly inhibit'* its ability to build presence and compete over the medium to long term (as cited by the Commission in paragraph 5.16 of the Draft Decision). However, the reality is that any deterioration in Virgin Australia's performance on the Australia-Hong Kong routes is a matter for Virgin Australia's management. Virgin Australia complains about its limited network relative to Qantas and Cathay (as cited in paragraph 5.16 of the Draft Decision). However, this reflects how the Virgin Group has elected to structure its international operations. These network and capacity decisions have been made independently by Virgin Australia, pre-date the Proposed Codeshare, are completely unrelated to the Proposed Codeshare and will not change as a result of the Proposed Codeshare.

The Commission goes as far as to say in paragraph 5.28 of the Draft Decision that the Proposed Codeshare:

*'is likely to lead to a market structure which makes it more difficult for Virgin Australia to compete and/or raises barriers for new entrants to enter the market. For this reason, the variation would not be conducive to fostering an environment where Australian carriers can effectively compete on the route in question'.*

To say that a codeshare that applies to *only five* flights on point to point services (and which in any event cannot be sold other than in conjunction with a through journey) will have such a meaningful impact on market structure is a significant conclusion that warrants a reasonable evidentiary basis. This is particularly so in circumstances where the 'marketing advantage' being promoted by the Proposed Codeshare is not in relation to point to point services (where Virgin Australia actively obtains approximately 80% of its traffic) but is instead directed to a different customer base of those passengers travelling behind and beyond the gateways – a customer base that so far has not been the focus of Virgin Australia's marketing and network decisions. As set out above, Qantas also rejects

the Commission's comments that the Proposed Codeshare *itself* could raise barriers to entry or expansion.

As we have stated, the Proposed Codeshare will not have any effect of preventing Virgin Australia from revisiting or changing its network, fleet and schedule planning decisions in future. In the Virgin Australia/Virgin Atlantic Application, it is asserted that the proposed alliance will be '*crucial to the sustainable operations of Virgin Australia's services between Australia and Hong Kong*' (page 1) by '*promoting passenger feed, reducing costs, and improved sales and marketing opportunities*' (page 25) and resulting in a '*material increase in revenue*' (page 27).

Consistent with Qantas' rationale for the Proposed Codeshare, Virgin Australia/Virgin Atlantic recognise the importance of behind and beyond traffic to the sustainability of Australia-Hong Kong services (page 15). However, unlike the Proposed Codeshare, Virgin Australia/Virgin Atlantic's proposed alliance involves full commercial cooperation on the Australia-Hong Kong routes, including jointly managing pricing, marketing and inventory. This includes the provision of special prorates which it is claimed will enable greater access to seat inventory at lower prices (page 7). This, in turn, is anticipated to produce pro-competitive responses from other carriers including Qantas. Rather than indicating that Australia-Hong Kong routes are stagnant or characterised by idle 'dominant' incumbents and the risk of a failing recent entrant, the case made by Virgin Australia/Virgin Atlantic is entirely consistent with Qantas' view that the routes are, and will remain, intensely competitive.

We would urge the Commission to re-consider its conclusion that Virgin Australia is unlikely to be able to effectively compete because of the Proposed Codeshare.

### **3. The Commission Has Given Too Much Weight To Hypothetical Possibilities That Favour Declining Approval**

As set out above, when considering the additional criteria in section 9 of the Policy Statement, the Commission has placed significant weight on whether Virgin Australia will continue to survive on the Australia-Hong Kong routes. By taking this focus, in Qantas' view, the Draft Decision overlooks the overarching acknowledgement in section 3 of the Act that the welfare of Australians is enhanced by *promoting economic efficiency through competition*, by inappropriately focusing on protecting a single competitor rather than the dynamic competitive process.

Any potential exit by Virgin Australia can only be something that is – at best – merely a potential future event and, even then, it would be a stretch to link that occurrence to the actual Proposed Codeshare. In paragraph 5.23 of the Draft Decision, the Commission refers to hypothetical prospects:

*'If the proposed codeshare were approved and, as the Commission considers likely, this results in the other two airlines increasing their market share, it is likely that Virgin will have a weakened, and **perhaps** materially weakened, position that **may** make it difficult for Virgin to sustain its operations.'* [emphasis added]

Later, when assessing likely price impacts, the Commission makes further speculative assumptions on effect (paragraph 5.37):

*'...it is possible that Virgin Australia **may** choose not to disrupt the softening of competition resulting from the Qantas-Cathay Pacific code share because Virgin Australia would benefit from the increase in airfares. **The Commission does not make a finding that such an outcome is likely, noting that Virgin Australia has been an effective competitor to date, but rather that it is likely that an environment **may** be created where Virgin Australia would have***

*less incentive to aggressively compete. The creation of such an environment would make it less likely that Australian carriers can effectively compete on the route in question.*  
[emphasis added]

The Commission (in paragraph 5.49(c) of the Draft Decision) further refers to the '*small but real chance*' of a reduction or cessation in Virgin Australia's operations as a result of the Proposed Codeshare.

For the Proposed Codeshare to be considered not of benefit to the public, there should be clear evidence to support this. As noted earlier, it is difficult to accept that the proposed, limitation codeshare expansion would be so materially detrimental to Virgin Australia's services (as suggested in paragraph 5.49(c) of the Draft Decision), particularly against a background of passenger growth and, now against the background of the Virgin Australia/Virgin Atlantic Application for Authorisation.

Despite all these above concerns being speculative, they are nevertheless given significant weight by the Commission. In contrast, the Draft Decision gives only passing and cursory reference to the actual tangible and immediate public benefits the Proposed Codeshare would deliver. In paragraph 5.42 of the Draft Decision, the Commission notes: '*Under the proposed variation there will likely be some benefits for passengers through increased connectivity and reduced connection times.*' Similar passing references to the public benefits of the Proposed Codeshare are made in paragraphs 5.62-5.64 of the Draft Decision.

This seems to be an inappropriate balance of benefit/detriment considerations, particularly in circumstances where policy objectives under the Act would favour approval rather than denial of the Proposed Codeshare altogether as explained further below.

#### **4. The Commission Fails To Acknowledge Qantas and Cathay's Investment and Innovation on the Route**

Qantas and Cathay's long standing and proven commitment to the Australia-Hong Kong routes is not given sufficient weight relative to the prospect of Virgin Australia's hypothetical and potential route exit. Both Qantas and Cathay have a history of pro-competitive capacity expansion, price competition and product and service innovation. The Proposed Codeshare is an extension of that effort and commitment and is in no way a stifling of the competition that has benefited consumers over many years. In Qantas' view, the Draft Decision neglects to give proper weight to the fact that the Proposed Codeshare would immediately deliver real and tangible consumer benefits through increased schedule choice, reduced connection times and frequent flyer benefits.

As the Commission acknowledges in paragraph 5.22 of the Draft Decision, both Qantas and Cathay have established themselves as operators on the Australia-Hong Kong route and have a 'following and reputation' meaning that passengers might actively choose to fly with them over Virgin Australia. This is a manifestation of the effective competition and innovation that the Act is supposed to encourage and foster. Examples of improved consumer options and innovation on the Hong Kong routes were provided in Qantas' submission of 11 February 2019.

Similarly, in paragraph 5.14 the Commission acknowledges that the choice of a long-haul carrier for the Australia-Hong Kong route will be driven by '*factors including flight schedule, frequency, pricing, class of travel and brand loyalty.*' Enhancing flight schedules and connectivity is exactly what the Proposed Codeshare is seeking to achieve, yet the Draft Decision deprives consumers of this benefit. Enhanced loyalty benefits under the Proposed Codeshare are also consistent with the objective of the Act and we reject the characterisation by the Commission that these are solely '*an internal*

*administrative decision of the airlines'* (paragraph 5.60 of the Draft Decision). They are a key consumer benefit offering product differentiation from other carriers. The Proposed Codeshare will deliver additional benefits to the public over and above what they would otherwise offer separately, through interlining or through the oneworld alliance. In Qantas' view, this has not been given sufficient weight in the Draft Decision.

The Proposed Codeshare represents a continuation of pro-competitive innovation and economic efficiency in circumstances where neither Qantas or Cathay can otherwise sell the relevant flights and journeys using their own capacity. Denying the proposed variation will stifle the ability of Qantas (and Cathay) to expand their competitive customer propositions in the absence of available fleet to deploy on the route (in the case of Qantas) or limited (or nil) opportunities for growth within capacity entitlements (in the case of Cathay).

#### **5. Qantas' Counterfactual Adopted In The Draft Decision Is Inaccurate**

In prior submissions, Qantas clearly indicated to the Commission that a failure to approve the Proposed Codeshare would result in existing commercial arrangements with Cathay being put at risk. The existing consumer benefits that have been realised from the additional route and connectivity options available to consumers are now expressly at risk over the longer term due to the limited ability to drive customer preferencing and, as a result, value to the overall codeshare relationship. The Commission's view in paragraph 5.91 of the Draft Decision – that Qantas and Cathay are 'unlikely to renegotiate' as a result of the Proposed Codeshare not being approved – is incorrect.

In fact, since the Draft Decision was issued on 24 May 2019, Qantas and Cathay have already commenced discussions to review the existing codeshare. The Commission has not appreciated that Cathay is already disincentivised to continue to allow Qantas the benefit of being able to sell additional routes and flights on its services if Qantas cannot – by virtue of regulatory inflexibility – reciprocate this ability for Cathay.

Similarly, the expectation in paragraph 5.96 of the Draft Decision that in a world without the Proposed Codeshare Qantas or Cathay will simply maintain the status quo is not correct. It is not a foregone conclusion that all other aspects of the codesharing between Qantas and Cathay will proceed. Contrary to paragraph 4.3 of the Draft Decision, Qantas does not codeshare on services operated by Cathay from Hong Kong to Brisbane, Melbourne or Sydney (or vice versa). That aspect of the codeshare relationship was approved by the relevant regulatory authorities in Hong Kong, but implementation of those aspects of the codeshare was always expressed to be subject to the Commission's approval of Cathay's codeshare on Qantas' services.

In respect to the supposed likelihood of both carriers adding capacity in the absence of the Proposed Codeshare (paragraph 5.96), Cathay has limited ability to add main gateway capacity; hence the Proposed Codeshare represented an economically efficient way to extend selling capability and price competition. Similarly, it is incorrect to assume that Qantas will add capacity in the absence of the Proposed Codeshare and will always continue to invest in the Hong Kong route, simply because it is an incumbent that has made good strategic choices on network and fleet.

#### **6. The Commission Should Err On The Side Of Permitting And Monitoring The Proposed Codeshare**

It would be wholly *consistent* with the objects of the Act and Policy Statement to permit the Proposed Codeshare on the basis of the information provided, particularly given the Commission's ability to review an approved codeshare at any time.

Qantas' application to vary Determination [2015] IASC 115 (as amended) was requested for the duration of the determination, which expires on 22 November 2020. In accordance with the Act, the Commission must start its consideration of the renewal of a full (five-year) determination at least 12 months before the end of the period during which the determination is in force – in this case in five months' time (November 2019). Although this is a short time to observe the Proposed Codeshare in practice, it provides an early opportunity for the Commission to review whether and how public benefits are being delivered, including the pro-competitive Virgin Australia / Virgin Atlantic Authorisation Application and potential for interim authorisation to be granted by the ACCC.

In addition to the upcoming requirement for Qantas to renew the determination in question, the Commission can review any determination at any stage under section 10(1) of the Act if any of the hypothetical concerns identified in the Draft Decision eventuate.

The Commission's statutory power to review and revoke approval for a codeshare at any time is supplemented by the ability of the ACCC to independently consider the codeshare operations under the *Competition and Consumer Act 2010* (Cth). At the invitation of the Commission, the ACCC has already provided a range of comments on the Qantas application, particularly in relation to the assessment of whether the Proposed Codeshare is likely to have a detrimental effect on competition in any relevant markets. This current consideration and consultation process has already created a regulatory environment where not just one, but two, statutory bodies have an informed interest in the Proposed Codeshare and an immediate ability to review such arrangements at any time if the hypothetical concerns about competitive impact ever eventuated.

Approving the application to enable the Proposed Codeshare to be implemented, with a commitment to monitoring, reviewing or potentially revoking any variation if public benefits failed to be delivered in due course, would be a far more appropriate exercise of the statutory powers conferred on the Commission.