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2 July 2019

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

Dear Ms Tucker

**Response to Qantas Airways' and Cathay Pacific's submissions regarding
Draft Decision [2019] IASC 204d**

Virgin Australia wishes to provide the International Air Services Commission with the enclosed comments on submissions lodged by Qantas Airways and Cathay Pacific on 14 June and 7 June 2019 respectively, both concerning Draft Decision [2019] IASC 204d.

If you have any questions or would like to discuss any aspect of our comments, please contact me directly on 02 8093 7114.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Lee-Anne Tomkins".

Lee-Anne Tomkins
General Manager Government and International Relations

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RESPONSE TO QANTAS AIRWAYS' AND CATHAY PACIFIC'S SUBMISSIONS REGARDING DRAFT DECISION [2019] IASC 204D

1 **General comments**

- 1.1 Virgin Australia has reviewed Draft Decision [2019] IASC 204d (Draft Decision), together with subsequent submissions lodged by Qantas Airways (Qantas) and Cathay Pacific. In our view, the Draft Decision should be upheld in its entirety as it is consistent with the *International Air Services Commission Act 1992* (Cth) (the Act) and International Air Services Commission Policy Statement 2018 (Cth) (the Policy Statement). As justification for this view, we would invite the International Air Services Commission (the Commission) to revisit each of the submissions we have lodged to this case. We affirm all arguments outlined in those submissions.
- 1.2 The Commission has correctly applied the relevant provisions of the Act and Policy Statement in reaching its conclusions in the Draft Decision, each of which are based on clear and logical analysis. In doing so, it has not taken into account any irrelevant considerations nor ignored any relevant considerations.
- 1.3 The Commission has assessed Qantas' application against the additional criteria contained in the Policy Statement. The Explanatory Statement to the Policy Statement provides that the "additional criteria are intended to support the Commission's pre-eminent consideration of fostering, encouraging and supporting an environment conducive to healthy competition between Australian and foreign carriers in the provision of international air services".¹ By rejecting the proposed increase in concentration of market power between Qantas and Cathay Pacific on the Hong Kong route, the Draft Decision seeks to support the maintenance of competition from Virgin Australia and potential new entrants, as required under the Commission's legislative framework.
- 1.4 In its submission of 14 June 2019, Qantas seems to suggest that the onus is on the Commission to justify why its application should not be approved. There is no presumption in favour of variation of a transfer application under the legislative framework. The evidence advanced by Qantas in relation to the public benefits its application would deliver is scant and incapable of satisfying almost all elements of the additional criteria. While the submission asks for re-examination of the Draft Decision with a view to reversal of its conclusion, Qantas has not provided any new evidence upon which such a re-examination could be based.

¹ Explanatory Statement to International Air Services Commission Policy Statement 2018, page 3.

PUBLIC VERSION

- 1.5 It is instructive to note that Qantas has not acknowledged in any of its submissions the fact that itself and Cathay Pacific have a virtual stranglehold on the route, with a frequency, capacity and passenger share of 89%, 90% and 92% respectively.² Nor do any of Qantas' submissions concede that its load factors are significantly stronger than those of Virgin Australia, or that Hong Kong Airlines exited the route in October 2018. These commercial realities and their competitive impact cannot be ignored, and it is appropriate that they were afforded due weight by the Commission in reaching its conclusions under the Draft Decision.
- 1.6 Qantas does, however, refer to the "long standing and proven commitment to the Australia-Hong Kong routes" by itself and Cathay Pacific in its recent submission. This highlights the dominance of the two carriers on the route and the challenge faced by other airlines in operating sustainably profitable services in competition with them.
- 1.7 Qantas' recent submission refers to the current joint application by Virgin Australia and Virgin Atlantic to the Australian Competition and Consumer Commission (ACCC) for authorisation of cooperation in relation to services between Australia and the United Kingdom/Ireland via the mid-points of Hong Kong and Los Angeles. This application is consistent with the submissions Virgin Australia has made to the current case. In several places, our application notes that a key benefit of the proposed cooperation is assisting us to improve the performance and sustainability of our services to Hong Kong. Virgin Australia and Virgin Atlantic do not operate on any overlapping routes and are not close competitors, in sharp contrast to Qantas and Cathay Pacific.

2 Qantas' submission of 14 June 2019

Our comments below are structured in reference to each of the six parts of Qantas' submission.

Part 1

- 2.1 The Commission has not placed undue weight on the impact that Qantas' application would have on point-to-point markets on the Hong Kong route. Trunk sectors between Australia and Hong Kong are necessarily encompassed in Qantas' application and the associated potential competitive impacts on such sectors are directly relevant to this case. It is therefore appropriate that these impacts were assessed by the Commission in reaching its Draft Decision.
- 2.2 Qantas suggests that the Draft Decision does not give adequate regard to the competitive constraints imposed on itself and Cathay Pacific. Apart from Virgin Australia's operations to Hong Kong, there are very limited constraints on the two carriers. As around 90% of passengers travelling to Hong Kong as a destination fly on non-stop services, competition offered by third country carriers on the route is extremely limited and cannot be viewed as representing a genuine constraint on the combined market power of Qantas and Cathay Pacific.

² Bureau of Infrastructure, Transport and Regional Economics, *International Airline Activity*, 12 months ending November 2018.

PUBLIC VERSION

- 2.3 As stated in our previous submissions, Virgin Australia's entry to the market has resulted in more service options and cheaper airfares for travellers on the Hong Kong route. The code share cooperation proposed by Qantas would alter the competitive landscape in favour of itself and Cathay Pacific, to the detriment of Virgin Australia. It would also act as a clear deterrent against another carrier entering the route.
- 2.4 As stated in the Draft Decision, it is logical to expect that the proposed cooperation will lead to higher loads on Qantas' (and Cathay Pacific's) services on the trunk sectors. In accordance with the principles of supply and demand, higher load factors will lead to fewer fares available in lower-priced booking classes, in circumstances of limited competition and the absence of regulation. Qantas and Cathay Pacific already enjoy load factors exceeding 80%.
- 2.5 The proposed code share cooperation would allow the two carriers to gain the benefits of schedule coordination, while reducing incentives to re-time flights to improve connectivity. This point is tacitly confirmed by Qantas on page 6 of its recent submission, where it states that, "Enhancing flight schedules and connectivity is exactly what the Proposed Codeshare is seeking to achieve..." (emphasis added).
- 2.6 The inability of a Hong Kong carrier to commence services to an Australian major gateway is a product of the current air services arrangements and serves to highlight the limited potential for the route to attract and sustain new competitors (e.g. the withdrawal of Hong Kong Airlines). In such a scenario, allowing the two strongest players on the route to increase their dominance would only weaken competition, not enhance it.

Part 2

- 2.7 *[CONFIDENTIAL MATERIAL REDACTED]*
- 2.8 Virgin Australia rejects Qantas' claim that, "...any deterioration in Virgin Australia's performance on the Hong Kong routes is a matter for Virgin Australia's management". This suggests that Virgin Australia operates its flights between Australia and Hong Kong in a vacuum, free from the impacts of competition. Such a view is divorced from commercial reality and does not reference the fact that Qantas and Cathay Pacific currently dominate the route in terms of capacity, frequency and market share.
- 2.9 In reference to Qantas' comments on the scope of our international network, our submissions have highlighted that our flights to Hong Kong are a core element of our international footprint. That we entered the Hong Kong route before Qantas proposed to expand its cooperation with Cathay Pacific does not change the fact that the proposal has the strong potential to weaken competition on the route, by making it more challenging for us to compete. Route networks are not static in nature and all commercially-focussed airlines continually review their services in light of prevailing competitive forces.
- 2.10 Qantas questions how a proposal that involves "...only five flights on point to point services...will have such a meaningful impact on market structure...". In this regard, it is important to note that the proposal entails code share services on five flights per

PUBLIC VERSION

day, or 1,825 flights each year. Based on published schedules, this is more than 1.3 times greater than the total capacity offered by Virgin Australia on the route. If Virgin Australia is providing effective competition on the market with lower levels of frequency and capacity compared to the proposed code share services, it would be logical to conclude that the proposed code share services would provide an even more “meaningful impact” on the competitive landscape.

- 2.11 Virgin Australia rejects Qantas’ assertion that the proposed code share is directed to a “...customer base that so far has not been the focus of Virgin Australia’s network and marketing decisions”. The application includes journeys from Australian domestic ports to the Australian international gateways, as well as connections beyond Hong Kong. Domestic connections to our Hong Kong services have been marketed since we commenced operations on the Hong Kong route. In addition, we also market connections beyond Hong Kong through our relationship with our alliance partners. As we point out in our application to the ACCC for authorisation of cooperation with Virgin Atlantic, behind and beyond traffic is important for the sustainability of our services to Hong Kong.

Part 3

- 2.12 The Commission has placed appropriate weight on the likely scenarios that would transpire if approval of Qantas’ application was granted. All the Commission’s conclusions are based on logic and evidence. In our view, Qantas has placed insufficient evidence before the Commission to prove that its proposal would benefit the public.
- 2.13 Competition is a dynamic phenomenon. The Act and Policy Statement are designed to ensure that such competition as it relates to the use of Australia’s capacity entitlements will enhance the welfare of Australians. Qantas has failed to provide evidence to prove that its proposed code share would deliver such an outcome.
- 2.14 There is clear evidence that the proposed code share is not of benefit to the public, as cited by the Commission in its Draft Decision. Notwithstanding this, the onus is on Qantas to provide evidence of the public benefits that its proposal will deliver when assessed against the additional criteria. Based on the material in the Draft Decision, the Commission has thoroughly assessed the evidence of proposed public benefits adduced by Qantas and determined that they are extremely limited, especially when balanced against the potential significant detriment that the proposal is likely to have in terms of allowing Qantas and Cathay Pacific to increase their market power, which would inevitably weaken competition on the route.

Part 4

- 2.15 The length of time that Qantas and Cathay Pacific have been serving the Hong Kong route cannot be accepted as a justification for approving the application. Rather, this fact confirms the dominant position the two carriers enjoy on the route, both individually and collectively.

PUBLIC VERSION

- 2.16 As stated in our submissions and in the Draft Decision, the proposed code share offers extremely limited benefits, via some small improvements in connection times and incremental frequent flyer benefits. The proposal does not provide travellers with access to any new services or destinations and frequent flyer points are already available to Qantas and Cathay Pacific customers via the oneworld alliance. In our opinion, Qantas' characterisation of such benefits as "real and tangible" is a significant overstatement.
- 2.17 Denying the proposed code share will not necessarily inhibit the ability of Qantas and Cathay Pacific to expand their presence on the Hong Kong route. Qantas indicates that expansion of the route is subject to aircraft availability, yet it has recently announced two new routes to the United States from Brisbane. In any event, it is a decision of Qantas' management as to how it deploys its fleet, including on the Hong Kong route, and this cannot be viewed as a justification for approving the application.
- 2.18 As for Cathay Pacific, it has the option to introduce services to a non-major gateway or encourage the Hong Kong Government to re-engage with the Australian Government with a view to negotiating an expanded capacity entitlement for Hong Kong carriers under the Australia-Hong Kong air services arrangements.
- 2.19 Again, this part of Qantas' submission fails to acknowledge that the proposal encompasses a code share on overlapping routes and the combined capacity, frequency and passenger shares held by the two carriers.

Part 5

- 2.20 Qantas, like every other Australian business, must structure its commercial affairs in accordance with relevant regulation. If Qantas and Cathay wish to restructure their commercial arrangements as a result of the Commission's Draft Decision, that is a matter entirely for them. The Commission must, as it has done in issuing the Draft Decision, perform its functions in accordance with the Act and the Policy Statement.
- 2.21 Apart from restrictions in the relevant air services arrangements, there are no regulatory impediments to Qantas and Cathay Pacific implementing reciprocal code share services behind/beyond the Australian international major gateways and Hong Kong. Qantas may also place its code on Cathay Pacific's flights to Australia. It is therefore clear that the carriers are already free to cooperate to a large extent regardless of the Draft Decision.

Part 6

- 2.22 Virgin Australia strongly opposes any amendment of the Draft Decision which would approve Qantas' application on a trial basis. The reasoning detailed in the Draft Decision clearly shows that approval of the application would provide extremely limited benefits while entailing a significant risk of creating an environment where Virgin Australia and potential new entrants are less able to effectively compete with Qantas and Cathay Pacific. Accordingly, rejection of the proposal promotes the object of the Act.

PUBLIC VERSION

- 2.23 The damage to competition that can be occasioned as a result of the approval of code share services on a provisional basis on overlapping routes served by the two strongest carriers on a route was demonstrated in the Papua New Guinea case in 2016.
- 2.24 If approval was granted for the duration of the Determination which is the subject of the application, Qantas would automatically receive the benefit of the presumption in favour of renewal, as provided under paragraph 14 of the Policy Statement. Therefore, there is a risk that an ostensibly provisional approval would amount to a permanent approval due to the presumption that would operate in Qantas' favour.
- 2.25 It is open to Qantas to lodge a fresh application for variation in the future, if there were significant changes in the competitive dynamics on the route. Such circumstances may include the substantial expansion of our services to approximately match the capacity offered by Qantas, a new carrier entering the route or the expansion or liberalisation of the capacity entitlement under the Australia-Hong Kong air services arrangements. Until that time, approval of such a proposal is unlikely to be consistent with the Act.

3 Cathay Pacific's submission of 7 June 2019

- 3.1 Cathay Pacific asserts that the inclusion of an Australian domestic sector in connection with a trunk sector would provide Australian travellers with increased simplicity and efficiency in arranging their travel to Hong Kong. As stated in previous submissions, this is completely incorrect, as such connections are available today. This cannot be touted as a benefit of the proposed cooperation.

4 Final observations

- 4.1 As outlined in these comments and our previous submissions, Virgin Australia is firmly of the view that approval of Qantas' application will not be of benefit to the public, due to the detrimental impact that it would have on competition on the Hong Kong route.
- 4.2 Based on logical and robust reasoning, the Draft Decision seeks to ensure that the competitive landscape for services between Australia and Hong Kong is not distorted by allowing the two carriers which currently dominate the route to unnecessarily expand their market power, at the expense of Virgin Australia, potential new entrants, exporters and the travelling public.