20 September 2011

Ms Sue McIntosh
Executive Director
International Air Services Commission
PO Box 630
Canberra ACT 2601

Dear Ms McIntosh

Review of code share arrangements between Qantas and South African Airways

On 6 September 2011, Virgin Australia wrote to the Commission advising that it did not object to Qantas' application for an extension of authorisations which permit it to code share with South African Airways (SAA) on services between Sydney and Johannesburg. While not objecting to the proposal Virgin Australia nevertheless took the opportunity to make a number of observations in relation to it.

Virgin Australia suggests that the determination not be granted for the five years sought by Qantas. As we have already put to the Commission, the accumulated and detailed knowledge of this market strongly suggests its characteristics are unlikely to change in the foreseeable future. That being the case, we believe it is appropriate to extend the current approval for the full five years available to the Commission. Rolling short term determinations do not give Qantas the investment certainty needed to develop the route over the long term and to effectively address the persistent challenges of the operating environment. This would ensure that we can invest with confidence to maintain legitimate profit, enhance consumer and welfare benefits and continue to build the route over time. Such an outcome would be fully consistent with the broad policy intent set down in the Government's Aviation White Paper.

Virgin Australia has also suggested conditions be attached to the size of the hard blocks purchased by the carriers. By suggesting that greater benefits might be derived by imposing such conditions Virgin Australia apparently does not contest that public benefit and competition are already present in these arrangements. This is a central tenet of our submission to the Commission. We oppose any suggestion the imposition of another layer of conditions might improve benefits already present in the arrangements.

Virgin Australia suggests the code share arrangements may have contributed to the challenges faced ultimately by V Australia in the South Africa market. In any aviation market new entrants are faced with significant challenges. Two important facts need to be considered in this context. First, V Australia entered a market which contained

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two incumbent carriers operating in competition with each other. The block space code share arrangements do not constrain that competition. Second, it is a relevant consideration that V Australia entered with two weekly services only (later increased to three) in a long haul international route in competition with established carriers operating daily services. The challenge no doubt compounded by the fact the incumbent carriers were supported by very significant investments, extensive product development and the reality that an important part of the market was made up of business traffic requiring the flexibility of daily services.

Virgin Australia's commentary on third country traffic elicits two observations. First, we understand around 30% of the total Australia – South Africa market is carried by third country carriers. Airlines and consumers clearly find merit in these arrangements. Second, as we have discussed with the Commission, there are valid reasons why consumers make such choices. For many passengers, the time penalty incurred in such services is compensated by cheaper prices; greater choice and flexibility, or by avoiding the inconvenience of domestic connections in both Australia and South Africa.

Notwithstanding Virgin Australia's views it remains a fact the Australia – South Africa Air Services Agreement is deficient in a number of areas, particularly in respect of access to beyond rights and third country code share arrangements. That Virgin Australia may also find itself constrained in placing its code on various third country carriers is not the defining issue. Simply, Qantas, a carrier actually operating on the route, is constrained by the air services arrangements from accessing certain market segments in a manner its competitors, SAA and third country carriers are not.

Observations that the code share arrangements are a special characteristic of the Australia – South Africa route need also to be addressed. Qantas operates over 1,200 code share flights globally with its various commercial partners. Virgin Australia itself operates many code share flights, as do its commercial partners and most of the world's airlines. An overwhelming majority of Governments actively support and encourage code share arrangements for sound public policy reasons. Code share provisions were included in the air services agreement by the Australian and South African governments in the full knowledge of the underlying characteristics of the market. In this context there is little that is remarkable about the arrangements in place between Qantas and SAA.

It remains our view that absent the code share arrangements it is possible the route ultimately could be served by a single direct carrier. It is not immediately clear who amongst the carriers qualified under the air services agreement to enter the market might do so. Virgin Australia's suggestion that the existence of the code share arrangements is a competitive deterrent to new entrants ignores two salient points – it did not deter V Australia from entering the market and the capital cost and operational constraints of establishing and maintaining a competitive presence on this route are far more likely to be relevant considerations.

Yours sincerely

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