



5 October 2012

Mr Chris Samuel
Senior Adviser
International Air Services Commission
GPO Box 630
Canberra ACT 2601

Chris
Dear Mr Samuel

Application for Renewal - Italy Route

I refer to your letter of 12 September inviting Qantas to address the criteria in paragraph 8 of the Minister's Policy Statement in support of our application to renew Determination [2007] IASC 113, allocating 600 third country code share seats on the Italy route.

Qantas' submission is attached.

We would be pleased to provide any further information the Commission may require in support of this application.

Yours sincerely

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Copy: Sue McIntosh



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APPLICATION FOR RENEWAL OF DETERMINATION [2007] IASC 113 SUPPLEMENTARY SUBMISSION

Qantas Airways Limited (Qantas) holds Determination [2007] IASC 113, which allocates 600 third country code share seats per week on the Italy route.

In accordance with section 17 of the Act, the International Air Services Commission (Commission) commenced consideration of the renewal of the determination in August. On 3 September, Qantas applied for renewal of Determination [2007] IASC 113 under section 8 the Act and this submission is made in support of Qantas' application to renew the determination.

Qantas is applying for renewal of Determination [2007] IASC 113 under paragraph 8 of the International Air Services Policy Statement dated 19 May 2004 (Policy Statement).

Proposed partnership between Qantas and Emirates

Subject to regulatory approval, including from the Australian Competition and Consumer Commission (ACCC), from April 2013, under a new global aviation partnership with Emirates, Qantas plans to commence direct services to Dubai and the two airlines propose to offer joint services across 120 destinations.

The partnership will give Qantas customers one-stop access to more than 70 Emirates destinations in Europe, the Middle East and Africa. For Emirates customers it will open up Qantas' Australian domestic network of more than 50 destinations and 5,000 flights per week. The carriers will also coordinate on their services between Australia and New Zealand and services between Australia and South East Asia.

In the event that approval is received, and prior to Qantas commencing to operate services to Europe via Dubai, Qantas will discontinue its current code share on Cathay Pacific Airlines' (Cathay Pacific) services between Hong Kong and Rome

The current determination allocating 600 third country code share seats per week on the Italy route to Qantas to provide joint services with Cathay Pacific expires 7 August 2013. Consequently, the ability for Qantas to utilise this capacity to provide joint services with Emirates under the new partnership will be subject to a separate application. However, due to the timing of the planned partnership with Emirates, the proposed code share is relevant to Qantas' application for renewal.

The Test for Renewal

Paragraph 8 of the Policy Statement sets out the criteria to be considered by the Commission when assessing the benefit to the public for the purposes of the renewal of a determination. Under the criteria in paragraph 8 there is a presumption in favour of the carrier seeking renewal, which may be rebutted only by application of the criteria in the circumstances described below.

Paragraph 8.1(b) of the Policy Statement provides that the consideration of the application for renewal is in favour of the carrier seeking renewal unless:

- "...the carrier seeking renewal has failed to service the route effectively; and
- ...use of the capacity in whole or part by another Australian carrier that has applied for the capacity would better serve the public having regard to the criteria set out in paragraphs 4 and 5." (emphasis added)

For the purposes of this analysis, the Commission must issue a renewal in favour of Qantas unless there is evidence of both the failure of Qantas to effectively service the route and that the use of part of the capacity by Virgin Australia would better serve the public in accordance with the criteria set out in paragraph 4 and 5 of the Policy Statement.

Effectively servicing the route

Qantas is an Australian carrier and has been serving the Australia-Italy route since 1948. In 2003, Qantas suspended own-operated services to Rome due to unsustainable losses against the background of extremely difficult operating environment for international airlines, with SARS compounding the consequences of the threat of terrorism and the events of 9/11.

The code share with Cathay Pacific commenced in 2003, with Qantas placing its code on five weekly services between Hong Kong and Rome. From 2006, the number of code share services marketed by Qantas increased to seven weekly services. These services have provided an ongoing direct service for passengers travelling between Australia and Italy and vice versa.

Qantas applied for renewal of Determination [2003] IASC 113 in August 2007 and in considering this application the delegate of the Commission noted that *"there is no evidence that Qantas has failed to service the route effectively."*

Since the renewed determination (Determination [2007] IASC 113) was issued in 2007, Qantas has used the capacity as efficiently as available to us by code sharing on all available frequencies operated by Cathay Pacific between Hong Kong and Rome.

Paragraph 4 of the Policy Statement

The general criteria to be considered by the Commission when considering benefit to the public is set out in paragraph 4 of the Policy Statement. These state that the use of entitlements by an Australian carrier under a bilateral arrangement is of benefit to the public, provided that the carrier is reasonably capable of obtaining the necessary approvals to operate on the route and implementing the proposal.

Qantas' application clearly meets the public benefit test in paragraph 4 of the Policy Statement. The code share with Cathay Pacific has delivered benefits to consumers in the form of higher frequency of service than had been operated on the route previously, which increased where possible, and supported Australian tourism and trade. Prior to Qantas first being allocated this capacity in 2003, which was renewed in 2007, the entitlement had been unused since being agreed in 1998.

Qantas is an established international carrier and it otherwise has the necessary approvals to operate on the route under the current arrangements.

As stated above, the proposed Qantas-Emirates partnership is subject to regulatory approval and the ability for Qantas to utilise this capacity to provide joint services with Emirates on the Italy route will be subject to a separate application to the Commission.

Paragraph 5 of the Policy Statement

Competition benefits

- i) *the need for Australian carriers to be able to compete effectively with one another and the carriers of foreign countries*

The Australia-Italy route is highly competitive, with a number of third country carriers serving the market including Singapore Airlines, Emirates, Cathay Pacific, Etihad Airways, Thai Airways, Air China, Korean Air, British Airways and Qatar Airways. Virgin Australia's interline agreement with Singapore Airlines allows it to offer services to Italy. The current code sharing arrangement facilitates competition between Qantas and both international and domestic carriers.

Qantas commenced code sharing with Cathay Pacific on flights between Hong Kong and Rome in 2003 following the suspension of own-operated services between Australia and Rome as a consequence of unsustainable losses on Qantas' Italy services.

While the number of passengers travelling on the route has grown over the past few years, Qantas' market share has been declining steadily. In the year ended June 2012, Qantas market share fell by approximately 8 per cent compared to 2009 levels to around 14 per cent market share. Over the same period as the number of passengers carried by Qantas has deteriorated, the total number of passengers on the route has grown by approximately 19 per cent.

The majority of Qantas' competitors on the route are mid-point carriers, many of which provide one-stop services in the Australia-Italy market from various Australian points. The current code share enables Qantas to offer daily flights on the route and better compete with these carriers.

Under the proposed partnership with Emirates, Qantas will move its hub for European flights to Dubai and enter an extensive commercial relationship with Emirates. Qantas will commence daily A380 services from both Sydney and Melbourne to London, via Dubai. This will provide another daily frequency (afternoon departure) to Dubai and beyond on Emirates' services to Italy.

The proposed partnership will significantly expand Qantas' service offering between Australia and Italy, allowing the ability to market a new point in Italy (Venice) and add up to four flights per day (or 28 flights per week) compared to the current code share with Cathay Pacific. As around half of passengers on the Italy route had an uplift/discharge (U/D) in the United Arab Emirates (UAE) and Singapore in the year ended June 2012, while around nine per cent of passengers travelled via Hong Kong, the commercial relationship with Emirates will enhance Qantas' ability to effectively compete on the route.

- ii) *the number of carriers on a particular route and the existing distribution of capacity between Australian carriers*

There are at least nine third country carriers on the Australia-Italy route, many of which provide one-stop services in the market from various points in Australia. Virgin Australia provides services on the Italy route under an interline agreement with Singapore Airlines.

Qantas is the only Australian carrier with an allocation of capacity on the Italy route, which supports third country code share services only. There is capacity available to

Australian carriers for other code share arrangements (including unlimited capacity for bilateral code share) and own-operated passenger services (seven frequencies per week) under the relevant arrangements.

iii) prospects for lower tariffs, increased choice and frequency of service and innovative product differentiation

The code share with Cathay Pacific has allowed Qantas to continue to offer services between Australia and Italy following the suspension of own-operated services in 2003. Cathay Pacific will operate five weekly services on the route in the upcoming scheduling season, with effect from 31 October. Today, the code share arrangement provides passengers with a daily return service to, from Rome on A340-300 aircraft configured with two classes (business and economy).

Under the code share arrangement with Cathay Pacific, Qantas serves the Italy route with a morning arrival in Rome (0650) and an afternoon departure ex Rome (1225). These timings are convenient for the leisure market, which comprises almost 80 per cent of travellers on the route (66 per cent travelling for holiday purposes and 13 per cent visiting friends and relatives).

The proposed partnership with Emirates will offer consumers significantly increased choice and frequency of service on the Australia-Italy route. Emirates have recently upgauged aircraft and/or increased frequencies to Italy and currently operate 49 return services per week between Australia and Italy, via Dubai. This includes double daily services to, from Rome, triple daily services to, from Milan and double daily services to, from Venice. These services are operated using a combination of A380-800, B777-300, A340-300 and A330-200 aircraft, configured with three classes.

Under Virgin Australia's proposal to code share with Singapore Airlines and Etihad Airways on the Italy route, the choice and frequency of service would be more limited with Singapore Airlines and Etihad Airways together operating 12 flights per week to Milan, while Singapore Airlines also operates two return flights per week to Rome.

Each of the carriers outlined above serve the Australia-Italy route via various mid-points including Hong Kong, Singapore, Abu Dhabi and Dubai. Despite the various mid-points served, there is not a significant variance between the distance for services between Australia and Italy, using the example of services between Sydney and Rome, with the difference between the shortest and longest routes being around 200 miles¹.

Emirates currently operates to three points in Italy – Rome, Milan and Venice – however, Australian carriers are able to serve only two points in Italy under the relevant air services arrangements. Even with this constraint, the public benefit is enhanced under the proposed partnership with Emirates as a result of the increased choice available for frequency and timing of services.

iv) the extent to which applicants are proposing to provide capacity on aircraft they will operate themselves

Under the current code share arrangement, Qantas operates the aircraft on services between Australia and Hong Kong and code shares on Cathay Pacific's services between Hong Kong and Rome.

¹ SYD-HKG-FCO - 10,358 miles; SYD-SIN-FCO - 10,156 miles; SYD-DXB-FCO - 10,183 miles; SYD-AUH-FCO - 10,191 miles (Source: Great Circle Mapper)

It is proposed that under the partnership with Emirates, Qantas will operate services between Australia and Dubai, as well as code share on Emirates' services, and code share on Emirates services between Dubai and Italy, subject to regulatory approval.

Tourism benefits

- i) the level of promotion, market development and investment proposed by each of the applicants*

Italy is a key international market, representing Australia's 19th largest route in terms of total origin/destination (O/D) traffic flows, with approximately 427,000 passengers travelling between the two countries in the year to end June 2012. More than 70 per cent of passengers travelling on the route are Australian residents with inbound visitors representing approximately 28 per cent of traffic in the year to end June 2012.

In financial year 2011/2012, Qantas spent more than AUD 100,000 on marketing activity in Italy.

- ii) route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s)*

Qantas provides strong links with the Qantas Group's domestic and international services, including beyond Australian gateways to New Zealand.

Consumer benefits

- i) the degree of choice (including, for example, choice of airport(s), seat availability, range of product).*

The current code share arrangement with Cathay Pacific and proposed partnership with Emirates allows Qantas to maintain a competitive presence on the Italy route and provides a greater level of choice for consumers.

The code share arrangements provide consumers with significant benefit by offering improved connectivity and increased flexibility of flying with a greater number of frequencies and timings available under the proposed Emirates partnership. Frequent Flyer members will also be able to access reciprocal rewards, recognition and lounge access as Qantas and Emirates frequent flyer programs will be aligned under the proposed partnership.

- ii) efficiencies achieved as reflected in lower tariffs and improved standards of service.*

Under the proposed partnership with Emirates, it is planned that Qantas will have preferential booking class access and vice versa, allowing access to additional inventory to support pricing activity that would otherwise be compromised because of limited seat availability. Such access would mean that sale fares are able to be offered across broader travel periods.

In addition, proposed preferential booking class access may result in fare savings on certain routes.

- iii) the stimulation of innovation on the part of incumbent carriers.*

Given the high number of competitors on the Italy route, almost all of which are premium full service airlines, there is an ongoing focus by incumbent carriers on

delivering sustainable product and service improvements to enhance customer experience.

- iv) route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s).*

The code share arrangements allow Qantas to serve the Italy route and provide strong links with the Qantas Group's domestic and international services.

Trade benefits

- i) the availability of frequent, low cost, reliable freight movement for Australian exporters and importers*

There are a number of operators on the Australia-Italy route which carry freight in the belly-hold of passenger aircraft. In addition, dedicated freight services are operated by some carriers which connect Europe with Australia via their respective hubs.

While the current code share arrangement with Cathay Pacific excludes the carriage of freight, it is proposed that the partnership between Qantas and Emirates will include freight related activities, providing greater choice for freight customers.

Industry structure

- i) the extent to which applications will impact positively on the Australian aviation industry*

The code share arrangement has had a positive impact on the Australian aviation industry by effectively utilising capacity to offer a daily frequency on the Italy route. The capacity had been unallocated since being available in the arrangements between Australia and Italy in 1998.

The ability for Qantas to continue code sharing on the Italy route would better equip it to compete effectively and sustainably with competitors which have grown their services in the market, strengthening the competitiveness of Australia's aviation industry and encouraging future investment and skills development in this sector.

In addition, continuation of the code share arrangements would maintain existing access on the route as well as enable Qantas to expand investment in an important tourism and trade market under the proposed partnership with Emirates.