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

Via email: iasc@infrastructure.gov.au

Dear Ms Tucker

Re: Qantas' application for variation to Determination [2015] IASC 115 (as varied) – Australia-Hong Kong

I refer to Qantas' application to vary Determination [2015] IASC 115 to permit Cathay Pacific (**Cathay**) to offer codeshare services on flights operated by Qantas between Australia and Hong Kong from 31 March 2019.

The IASC has invited the ACCC to provide comments on Qantas' application. I note that your request is *not* in the context of formal consultation under the *International Air Services Commission Act* (1992). Rather, you are seeking our input on an informal basis.

Background

Determination [2015] IASC 115 allocates Qantas 28 frequencies per week in each direction between Australia and Hong Kong, which can be used by Qantas to supply services jointly with Qantas' wholly owned subsidiaries or codeshare partners British Airways, Jet Airways or Finnair. Subsequent variations have allowed Qantas to also use this capacity to codeshare with EI Airline¹, LATAM Airlines² and Air France.³

The ACCC understands that pursuant to codeshare agreements between Qantas and Cathay/Cathay Dragon dated 29 August 2018 (**the Codeshare Agreement**) and subsequent international regulatory approvals:

- Qantas can currently place its code:

¹ [2014] IASC 103.

² [2017] IASC 218.

³ [2018] IASC 214.

- on 15 one-way routes operated by Cathay/Cathay Dragon within Asia from Hong Kong to certain destinations in India, Myanmar, Sri Lanka and Vietnam and
- on Cathay's services from Hong Kong to Perth and from Hong Kong to Cairns (routes which are not operated by Qantas) and
- Cathay can currently place its code on 25 one-way routes operated by Qantas on the domestic Australian network.

The application for variation

Qantas and Cathay propose to expand their codeshare services (pursuant to an **Updated Annex**) to enable:

- Qantas to add its code to an additional 19 one-way routes operated by Cathay/Cathay Dragon from Hong Kong to India, Japan, South Korea and Sri Lanka
- Qantas to add its code to select Cathay services from Hong Kong to Sydney, Melbourne and Brisbane, where passengers are connecting to a Qantas Australian domestic service
- Cathay to add its code to an additional 32 one-way domestic Australian routes operated by Qantas
- Cathay to add its code to select Qantas services from Sydney, Melbourne and Brisbane to Hong Kong, where passengers are connecting to a Cathay/Cathay Dragon service to another destination in Asia.

The ACCC understands that the application lodged by Qantas on 8 January 2019 seeks approval from the IASC to engage in the conduct described in the fourth bullet point above. That is, for Cathay to add its code to select Qantas services from Sydney, Melbourne and Brisbane to Hong Kong when these services are sold in conjunction with a connecting Cathay/Cathay Dragon service between Hong Kong to another destination in Asia (**the Proposed Variation**).

The ACCC understands that Qantas and Cathay do not require approval from the IASC to engage in the other three elements of the proposed expanded codeshare arrangement. The ACCC further understands that Qantas and Cathay have received the necessary approvals from international regulators to engage in the first two elements of the proposed expanded codeshare arrangement.

Previous assessments by the IASC

The IASC has previously considered the impact on competition of Qantas code sharing on the Hong Kong route with carriers which do not themselves fly the route. In granting these applications, the IASC noted that these codeshares add to the number of carriers that market services between Australia and Hong Kong and are unlikely to have a detrimental impact on competition.

Unlike past applications, Qantas is now seeking to codeshare with Cathay on certain flights on city pairs where both carriers currently operate services.

Current services between Australia and Hong Kong

Virgin, Qantas and Cathay are the only operators on the route, since Hong Kong Airways ceased services in October 2018. Virgin is the smallest carrier on the route, with Qantas operating twice as many frequencies, while Cathay operates more than twice the frequencies of Qantas.

Table 1: Frequencies between Hong Kong and Australia per week by city and carrier

	Virgin	Qantas	Cathay
Adelaide/HK			6
Brisbane/HK		5-7	11
Cairns/HK			3
Melbourne/HK	7	7	21
Perth/HK			10
Sydney/HK	7	12-14	28
Total	14	24-28	79
Share of frequencies	12%	23%	65%

Source: 2018-19 Northern Winter IATA scheduling period⁴

Qantas has been allocated 28 weekly frequencies each way between Hong Kong and Australia, while Virgin has been allocated 14 weekly frequencies.⁵ 28 weekly frequencies between Hong Kong and Australia remain available for allocation.⁶

Assessment of effect on competition

This letter sets out a number of issues that the IASC may wish to take into consideration in its assessment of whether the Proposed Variation is likely to have a detrimental effect on competition in any relevant markets.

Relevant markets

The ACCC considers that the Proposed Variation has the potential to impact competition in the following markets:

- (a) Australia-Hong Kong air passenger services market – this market includes direct flights between Australian international gateways and Hong Kong. Passengers who travel on these flights may be travelling between international gateways only, or as part of a journey that originates or ends at an airport in Australia that is not an international gateway or at an airport in Asia that is not Hong Kong.

⁴ Northern summer 2018 International Airlines Timetable Summary Updated 22/11/2018, pages 10 and 11.

⁵ [2015] IASC 115 and [2018] IASC 106.

⁶ DIRD Register of Available Capacity, amended 20 March 2018, pages 38 and 39.

- (b) Australian domestic air passenger services market – this market encompasses all regular scheduled passenger flights within Australia, including those taken by passengers connecting to/from an international flight.

The ACCC recognises that the IASC does not issue determinations in respect of Australian domestic services.

Likely future without the Proposed Variation

It will be important for the IASC to consider the likely future without the Proposed Variation in its assessment of any potential competitive harm.

For the assessment that the IASC is undertaking, the ACCC considers that this likely ‘future without’ would involve the following in relation to Australia-Hong Kong services:

- Cathay and Qantas would continue to implement the Codeshare Agreement and implement elements of the Updated Annex – but Cathay would not add its code on Qantas services from Sydney, Melbourne and Brisbane to Hong Kong where passengers are connecting to another destination in Asia.
- Each airline would utilise the capacity allocated to them by the IASC and international regulators and would add capacity, taking up available unallocated capacity, depending on growth in passenger demand and the competitiveness of their offering.
- Virgin would continue to operate and market services between Australia and Hong Kong and market through-journeys to other destinations in Asia via Hong Kong under its alliance with Hong Kong Airlines.

Impact of the Proposed Variation on competition in the Australia-Hong Kong air passenger services market

Cathay and Qantas are (in that order) by far the largest and second largest competitors in this market. Vigorous competition between these two carriers is critical to the process of competition in the Australia-Hong Kong air passenger services market.

I note that if we were to assess this arrangement in our role of enforcing the *Competition and Consumer Act 2010*, the ACCC would normally assess the competition impact of the codeshare arrangement between Qantas and Cathay/Cathay Dragon in its totality. However, in this instance, the ACCC has been asked to comment only on that component involving Cathay adding its code on selected Qantas services from Sydney, Melbourne and Brisbane to Hong Kong where passengers are connecting to a Cathay/Cathay Dragon service to another destination in Asia.

We view this element of the proposed expanded codeshare arrangement as completing the reciprocal arrangement between the two airlines to codeshare on overlap routes where passengers are travelling through an international gateway in Australia and/or Hong Kong.

While it is a decision for the IASC to make, our main competition concern is that the conduct may soften competition in the Australia-Hong Kong air passengers services market by making it easier for Qantas and Cathay to coordinate their price and capacity decisions so as to raise price (or reduce service) for Australia-Hong Kong passengers who connect with a domestic Australia flight and/or a flight between Hong Kong and places in Asia. For example, this may include delaying the deployment of additional capacity between Australia and Hong Kong.

The realisation of this competitive harm will depend on a number of factors that we believe merit scrutiny, including:

- the importance of connecting passengers for Qantas' and Cathay's load factors, yield and capacity planning decisions on Australia-Hong Kong services;
- whether, absent IASC approval of the Proposed Variation, Qantas is able to continue to add its code on selected Cathay services from Hong Kong to Sydney, Melbourne and Brisbane, where passengers are connecting to a Qantas Australian domestic service;
- the extent to which the Qantas flights on which Cathay will codeshare have been selected to minimise schedule overlap to incentivise each carrier to continue to promote and market their own metal services whilst utilising the codeshare flights to maximise connectivity options to each carrier's extensive behind/beyond networks; and
- the extent to which Virgin, together with its alliance partner Hong Kong Airlines, is likely to disrupt any attempt by Qantas and/or Cathay under the arrangement to raise price (or reduce service). Here it will be relevant to consider not just whether Virgin *could* disrupt, but whether Virgin *would be likely to* disrupt any softening of competition between Qantas and Cathay. It may be more profitable for Virgin to not disrupt a softening of competition between the two largest carriers.

If the IASC decides to approve the variation of the Determination, we consider it would be prudent for the IASC to closely monitor Qantas and Cathay's behaviour on the route and Virgin Australia's response. In doing so, the IASC may wish to monitor the carriers' load factors, capacity flown, yield, and route profitability as well as take-up of available spare capacity on the route, including by Virgin Australia.

General position re hard block vs free sale code sharing

Qantas' submission to the IASC dated 11 February 2019 specifies that under the codeshare arrangement, the operating carrier provides the marketing carrier with access to available inventory on a free sale basis.

The ACCC's views on free sale versus hard block codeshare arrangements were set out in detail in its submission to the IASC on the application for variation lodged by Qantas in relation to the Papua New Guinea route in 2016.⁷

The ACCC remains of the view that, from a competition perspective, a hard block codeshare generally is preferable to a free sale codeshare since it maintains a greater degree of rivalry between the airlines.

⁷ Letter from the ACCC to the IASC dated 6 October 2016, pages 2 - 4.

Role of the ACCC

I note that any decision by the IASC to approve the Proposed Variation would not provide any protection for the airlines under the *Competition and Consumer Act 2010* and would not prejudice any possible future consideration of codeshare operations by the ACCC.

I hope that this letter assists you in your consideration of the application from Qantas. If you wish to discuss any aspect of this letter further, please do not hesitate to call Darrell Channing on 02 6243 4925.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'D Jones', is positioned above the typed name.

David Jones
General Manager
Adjudication