Australian Government

International Air Services Commission

DRAFT DECISION

Decision: [2019] IASC 204d
Variation of: [2015] IASC 115
The Route: Hong Kong
The Applicant: Qantas Airways Ltd (ABN 16 009 661 901)
Public Register File: IASC/APP/201902

The Commission, after conducting a review, proposes to make a decision under section 25 of the *International Air Services Commission Act 1992* not to vary Determination [2015] IASC 115 in the manner requested by Qantas.

1 The application and submissions

The application

1.1 Qantas Airways Limited (Qantas) has applied to the International Air Services Commission (the Commission) seeking to vary Determination [2015] IASC 115, as amended, (the Determination) to enable Cathay Pacific to market and place its code on the following selected flights operated by Qantas, when those flights are sold as part of a through journey to behind and/or beyond destinations:

Table 1: Specific flights covered by the proposed variation

City pairs	Qantas flight	Time and flight details (Northern Summer 2019)
Hong Kong- Sydney	QF 118	22:35 – 10:00+1
Melbourne- Hong Kong	QF 29	09:40 - 17:20
Hong Kong-Melbourne	QF 30	20:10 – 07:35+1
Brisbane-Hong Kong	QF 97	10:10 – 17:25
Hong Kong-Brisbane	QF 98	20:15 – 07:00+1

Chronology of the application and submissions

1.2 On 8 January 2019, Qantas applied to the Commission to vary the Determination to permit the utilisation of capacity for code share services with Cathay Pacific on the Hong Kong route. Qantas indicated in its application that as part of a free-sale code share agreement between Qantas and Cathay Pacific, it is proposed that Cathay Pacific will market its code on certain flights operated by Qantas on the Hong Kong route from 31 March 2019.

1.3 In accordance with section 22 of the *International Air Services Commission Act 1992* (the Act), the Commission published, on 8 January 2019, a notice inviting submissions about the application. Virgin Australia and the Australian Competition and Consumer Commission (ACCC) provided submissions to the Commission, on 22 and 23 January 2019, respectively. Both the ACCC and Virgin Australia indicated that they would provide substantive submissions once Qantas provided further information to clarify its application. Virgin Australia nonetheless expressed 'significant concerns' with the Qantas application, being that the proposed variation "will result in an unnecessary expansion of both Qantas and Cathay Pacific's market power,, to the detriment of the travelling public"[1].

1.4 On 25 January 2019, the Commission asked Qantas to provide more information about the proposed variation to the Determination and to address the criteria set out in section 9 of the 2018 Minister's Policy Statement. The Commission also asked Qantas to demonstrate how its proposed code share with Cathay Pacific would achieve the object of the Act, specifically by enhancing the welfare of Australians through promoting economic efficiency and through competition in the provision of international services, resulting in:

a) increased responsiveness by airlines to the needs of consumers, including an increased range of choices and benefits;
b) growth in Australian tourism and trade; and
c) maintenance of Australian carriers capable of competing effectively with airlines of foreign countries.

1.5 On 11 February 2019, Qantas responded with more information about the requested variation and addressed certain criteria contained in section 9 of the Policy Statement. In further communication, Qantas confirmed that its variation application is limited only to the selected flights listed in table 1 above, and only when those flights are sold as part of a through journey to behind and/or beyond destinations.

1.6 Qantas' letter of 11 February 2019 and the airline's subsequent responses to the Commission, where the specific flights to be covered by the proposed variation were detailed, had the effect of clarifying the scope of the variation requested in the Qantas application of 8 January 2019.

1.7 Virgin Australia and the ACCC provided substantive comments on 26 and 28 February 2019, respectively. Qantas was accorded the opportunity to respond to these submissions, and it lodged its response on 15 March 2019.

[1] Virgin Australia submission dated 22 January 2019, page 1.

1.8 In its submission of 15 March 2019, Qantas illustrated the through journeys to be included in the proposed variation, as follows:

Table 2(a): Potential routing of through-journeys

Zone	Routing
Zone 1	Domestic Australia (all ports): Brisbane/Melbourne/Sydney (vice versa)
Zone 2	Brisbane/Melbourne/Sydney (Selected flights only) – Hong Kong (vice versa)
Zone 3	Hong Kong – international destinations (vice versa)

Table 2(b): Potential through-journeys

Potential through-journeys	Included in the proposed variation (can be sold by Cathay Pacific under its code)
Zone 1 + Zone 2 Example: Canberra–Sydney–Hong Kong	Yes
Zone 1 + Zone 2 + Zone 3 Example: Albury – Melbourne – Hong Kong – Narita	Yes
Zone 2 alone Sydney – Hong Kong Melbourne – Hong Kong Brisbane – Hong Kong	No
Zone 2 + Zone 3 Example: Brisbane–Hong Kong–Delhi	Yes
Zone 3 + Zone 2 + Zone 1 Example: Okinawa–Hong Kong–Brisbane–Townsville	Yes

1.9 On 26 March 2019, the ACCC sent a letter clarifying a statement in its submission of 28 February 2019. On 28 March 2019, Virgin Australia lodged a follow-up submission in response to Qantas' 15 March 2019 submission. On 9 April 2019, Qantas submitted a response to Virgin's submission of 28 March 2019.

1.10 All non-confidential material supplied by the applicant and submissions received from stakeholders are available on the Commission's website, www.iasc.gov.au.

1.11 The Commission has carefully considered all of the material before it, including each of the submissions made by Qantas, Virgin Australia and the ACCC.

<u>The Determination</u>

1.12 The Determination sought to be varied currently allocates 28 weekly frequencies of passenger capacity to Qantas to operate services between the major Australian international gateways (Sydney, Melbourne, Brisbane and Perth) and Hong Kong. The Determination permits the capacity to be used by either Qantas or another Australian carrier which is a wholly-owned subsidiary of Qantas (which in this case is Jetstar Airways Pty Limited) and for code sharing between them. Additionally, the Determination permits code share services between Qantas and the following third country airlines: British Airways[2], El Al Israel[3], Finnair[4], Jet Airways[5], LATAM[6] and Air France[7]. None of these foreign airlines that are code sharing with Qantas between Australia and Hong Kong operate direct services on the route.

2 Relevant provisions of the air services arrangements

2.1 Paragraph 7(2)(aa) of the Act provides that the Commission must not allocate available capacity contrary to any restrictions on capacity contained in a bilateral arrangement(s). Any variation made to an existing allocation of capacity should also not be contrary to any restrictions on capacity contained in a bilateral arrangement(s).

2.2 Under the Australia–Hong Kong air services arrangements, there are 70 frequencies per week in each direction for passenger services which may be allocated to Australian designated carriers to operate passenger air services to and from Sydney, Brisbane, Melbourne and Perth. There is unlimited capacity to and from all other points in Australia. There are 2 frequencies per week for the operation of all-cargo services. The passenger capacity and all-cargo capacity entitlements may be used interchangeably.

2.3 Qantas has been allocated 28 frequencies of passenger capacity per week in each direction and one frequency to operate all-cargo services. Virgin Australia has an allocation of 14 frequencies per week in each direction. 28 frequencies of passenger capacity and one frequency per week in each direction for dedicated freight service remain unallocated.

2.4 Under the Australia–Hong Kong air services arrangements, a designated airline of Australia may, subject to conditions, enter into code share arrangements, whether as the operating or marketing airline, in respect of passenger or freighter services with another designated airline(s) of Australia, an airline(s) of Hong Kong and an airline(s) of a third country or countries. Capacity used under code share arrangements by the marketing carrier is counted against the capacity entitlements of the operating carrier.

3 Requirements under the Act and Minister's Policy Statement

3.1 Qantas' application seeks to vary the Determination to include a condition of a kind referred to in paragraph 15(2)(e) of the Act. In view of this, the application is a transfer application as so defined in subsection 4(1) of the Act, and has been assessed in accordance with section 25.

3.2 Subsection 25(1) provides that the Commission must make a decision varying the determination in a way that gives effect to the variation requested, subject to subsection 25(2). Subsection 25(2) states that the Commission must not make a decision varying the determination in a way that varies, or has the effect of varying an allocation of capacity if the Commission is satisfied that the allocation, as so varied, would not be of benefit to the public.

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[2] [2015] IASC 115
[3] [2017] IASC 213
[4] [2015] IASC 115
[5] [2015] IASC 115
[6] [2017] IASC 218
[7] [2018] IASC 214

3.3 The Act does not define 'benefit to the public'. However, section 26 of the Act provides that "[i]n assessing the benefit to the public of a variation of an allocation of capacity, the Commission must apply the criteria set out for that purpose in any policy statements made by the Minister under section 11".

3.4 In accordance with section 11 of the Act, the Minister made the International Air Services Commission Policy Statement 2018 (the Policy Statement) which came into effect on 28 March 2018. The Policy Statement sets out the criteria which the Commission is required to apply in assessing the benefit to the public of allocations of capacity.

3.5 Section 6 of the Policy Statement provides, in part, that the Commission is to perform its functions in a way that will achieve the object of the Act (that is, to promote economic efficiency through competition in the provision of international air services) by fostering, encouraging and supporting competition in the provision of international air services by Australian carriers.

3.6 Section 18 of the Policy Statement which specifically deals with 'transfer applications' such as this one, provides in part that, in assessing whether the variation requested would not be of benefit to the public for purposes of subsection 25(2) of the Act, the Commission is to have regard to certain matters including the 'reasonable capability criterion' in section 8 of the Policy Statement and may have regard to any of the additional criteria set out in section 9 of the Policy Statement that it considers to be relevant.

3.7 Under the 'reasonable capability criterion' in section 8 of the Policy Statement, the Commission is to assess the extent to which an Australian carrier is reasonably capable of obtaining any licences, permits or other approvals required to operate on and service the route and of using the capacity allocated under the determination. The Commission notes that Qantas is an established international carrier, and therefore finds that it is reasonably capable of obtaining the necessary regulatory approvals and of using the capacity on the route.

3.8 The Commission finds that the matters specified in paragraph 18(2)(b)[8] of the Policy Statement are not relevant to the variation under consideration. There is nothing to suggest that Qantas' transfer application will or is reasonably likely to permit or encourage any form of speculative activity, and Qantas has exercised the allocation in question for a period of more than six months.

3.9 The Commission's assessment of the Qantas application against the additional criteria in section 9 of the Policy Statement is detailed below.

[8] Paragraph 18(2)(b) provides that the Commission is to have regard to the following matters, to the extent that they are relevant to the variation under consideration: (i) the undesirability of approving a transfer where doing so will, or is reasonably likely to, permit or encourage any form of speculative activity, including trading in capacity allocations for commercial benefit; (ii) the undesirability, other than in exceptional cases, of approving a transfer application made by a carrier that has never exercised an allocation for a period of less than six months.

4 Overview of services operating on the Australia–Hong Kong route

4.1 Both Qantas and Virgin Australia indicated in their submissions that the Australia-Hong Kong route is growing in terms of passenger demand.[9] The aviation data below sourced from the Bureau of Infrastructure, Transport and Regional Economics (BITRE) confirms that both the capacity for inbound travel operated by the airlines (i.e. seats available) and the passengers carried by these airlines have grown over the last 3 years.

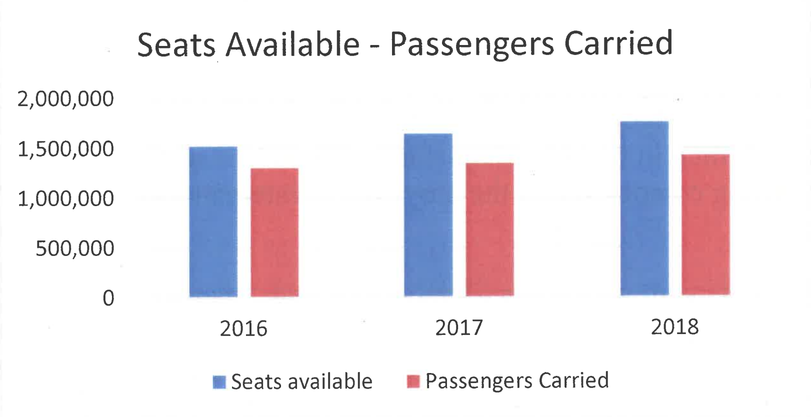

Table 3 – Capacity - Passengers Carried – Seat utilisation (Jan-Dec)/Inbound Airline supplied data – prepared by BITRE

2016			
	Seats available / Capacity	**Passengers Carried**	**Seat Utilisation / Load factor**
Cathay Pacific Airways	1,032,994	912,470	88%
Qantas	449,013	363,322	81%
Virgin Australia (no services operated in 2016)			
Hong Kong Airlines	40,871	27,535	67%
Total	**1,522,878**	**1,303,327**	
2017			
	Seats available / Capacity	**Passengers Carried**	**Seat Utilisation / Load factor**
Cathay Pacific Airways	1,073,977	904,570	84%
Qantas	469,191	374,914	80%
Virgin Australia (Melbourne-HK, from July 2017)	39,325	25,435	65%
Hong Kong Airlines	61,904	41,707	67%
Total	**1,644,397**	**1,346,626**	
2018			
	Seats available / Capacity	**Passengers Carried**	**Seat Utilisation / Load factor**
Cathay Pacific Airways	1,116,524	925,183	83%
Qantas	458,840	379,354	83%
Virgin Australia (commenced Sydney-HK, July 2018)	139,425	93,930	67%
Hong Kong Airlines (ceased operating end of October 2018)	45,260	26,343	58%
Total	**1,760,049**	**1,424,810**	

[9] Qantas submission dated 11 February 2019, page 3. Virgin Australia submission dated 26 February 2019 paragraph 2.5, page 2.

Cathay Pacific operations

4.2 Cathay Pacific has been allocated all of the capacity entitlements available to Hong Kong carriers to operate from Hong Kong to the major gateways of Australia, vice versa (Sydney, Brisbane, Melbourne including Avalon and Perth). In addition, it operates to and from Adelaide and Cairns. Cathay Pacific and Qantas use a range of aircraft types on the route, and BITRE data indicate that both airlines have historically managed capacity to align with market demand.

4.3 Cathay Pacific operates up to 79 frequencies per week between Australia and Hong Kong. Direct services from Hong Kong operate to Adelaide, Brisbane, Cairns, Melbourne, Perth and Sydney, vice versa. (The Commission notes that the international airlines timetable summary for northern summer 2019, March-October 2019, has just been released. It indicates that Cathay Pacific will operate up to 76 weekly frequencies in each direction. Cathay Pacific will continue to utilise the full capacity for passenger services to and from the major Australian gateways.) Qantas code shares, as marketing carrier, on the Cairns and Perth services (where Qantas does not operate) [10] and on the services operated by Cathay Pacific from Hong Kong to Brisbane and Melbourne vice versa and Hong Kong-Sydney[11]. These code share arrangements do not require the Commission's approval as Australian capacity entitlements are not being utilised by Qantas as the marketing carrier.

4.4 The following third country airlines also code share on Cathay Pacific services between Australia and Hong Kong: Air Astana, British Airways, Finnair, Japan Airlines, Lufthansa, MIAT Mongolian Airlines, Qatar Airways and Swiss International Airlines.[12]

Qantas' operations

4.5 Qantas operates up to 28 frequencies per week from Brisbane, Melbourne and Sydney to Hong Kong, vice versa.

4.6 Qantas has code share arrangements, as marketing carrier, with the following airlines enabling it to offer through tickets from Australia via Hong Kong to various destinations[13]:

a) *Qantas-Cathay Dragon*: Hong Kong – India/Vietnam/Myanmar*
b) *Qantas-Cathay Pacific*: Hong Kong – Sri Lanka/ India/ Vietnam*
c) *Qantas-El Al*: Hong Kong – Tel Aviv*
d) *Qantas-Jet Airways*[14]: Hong Kong – India*
e) *Qantas-Jetstar Pacific*: Hong Kong – Vietnam*
f) *Qantas-Cathay Pacific*: Hong Kong – Korea**
g) *Qantas-Cathay Dragon*: Hong Kong – Korea**

* Qantas as marketing carrier does not require the Commission's approval because the capacity offered by Qantas as the marketing carrier will not be counted against Australian capacity entitlements.
** Qantas required the Commission's approval which was given under Decision [2019] IASC 103.

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[10] International airlines timetable summary Northern Winter 2018-19
[11] International airlines timetable summary Northern Summer 2019
[12] International airlines timetable Summary Northern Winter 2018-19
[13] Ibid.
[14] The Commission notes the announcement by the Jet Airways CEO on 18 April 2019 that the airlines have temporarily suspended all of their operations until further notice.

4.7 Third country airlines (listed below) code share, as marketing carriers, on flights operated by Qantas between Australia and Hong Kong. These code share arrangements between Australia and Hong Kong required the Commission's approval. The code share partner(s) of Qantas operate(s) the second segment of the journey (i.e. Hong Kong to beyond destinations), which did not require approval from the Commission.

a) *British Airways*: Australia-HK-London (IASC approved [2015] IASC 115)
b) *El Al*: Australia-HK-Israel (IASC approved [2017] IASC 213)
c) *Finnair*: Australia-HK-Helsinki (IASC approved [2015] IASC 115)
d) *Jet Airways*: Australia-HK-India (IASC approved [2015] IASC 115)
e) *LATAM*: Australia-HK-Chile (IASC approved [2017] IASC 218)
f) *Air France*: Australia-HK-Paris (IASC approved [2018] IASC 214)

4.8 None of the codeshare partners identified in 4.7 operates a direct service between Australia and Hong Kong. The Commission notes that the air services arrangements between Australia and Hong Kong prohibit third country airlines from operating direct services on the route.

Virgin Australia operations

4.9 Virgin Australia flies daily services from Sydney to Hong Kong and daily services from Melbourne to Hong Kong, vice versa.

4.10 Additionally, Virgin Australia markets a code share, on flights operated by Singapore Airlines to Hong Kong via Singapore.

Australia – Singapore – Hong Kong

4.11 Virgin Australia code shares beyond Hong Kong with Virgin Atlantic. Virgin Australia operates Sydney/Melbourne-Hong Kong and Virgin Atlantic operates the Hong Kong-London segment.

Sydney/ Melbourne – Hong Kong – London

4.12 Hong Kong Airlines market a code share on flights operated by Virgin Australia between Australia and Hong Kong. Hong Kong Airlines ceased operating its own services on the Australia-Hong Kong route at the end of October 2018.

Hong Kong Airlines' previous operations

4.13 Hong Kong Airlines operated on the route from 2016 to 2018. Initially it operated two weekly services, which increased to seven, flying from Hong Kong to the Gold Coast and Cairns then back to Hong Kong. In 2017, the Commission approved a proposal from Virgin Australia to code share with Hong Kong Airlines as marketing carrier, on services operated by Virgin Australia. In assessing the Virgin Australia-Hong Kong Airlines code share arrangement, the Commission considered that the code share would have limited impact on competition given that the services of the two carriers on the route did not overlap.[15]

[15] [2017] IASC 212

4.14 Hong Kong Airlines ceased operating the Australia–Hong Kong service at the end of October 2018 and Cathay Pacific is currently the only Hong Kong carrier that operates direct services between Hong Kong and Australia.

5 Commission's assessment against section 9 of the Minister's Policy Statement

Competition criteria

Subsection 9(a): desirability of fostering an environment in which Australian carriers can effectively compete with each other and with foreign carriers on the route in question

5.1 As described in the preceding section, there are three carriers currently providing direct services between Australia and Hong Kong: Cathay Pacific, Qantas and Virgin Australia.

Summary of the Updated Code Share Arrangement between Qantas and Cathay Pacific/Cathay Dragon

5.2 Qantas indicated in its submission of 11 February 2019, the code share arrangement between Qantas and Cathay Pacific:

> "prohibits either party from selling airfares on respective codeshare flights for the origin/destination routes where both carriers operate – namely, Sydney/Melbourne/Brisbane to Hong Kong (the Point-to-Point routes). Under the Proposal, only certain flights on these Point to Point Routes can be sold using the other carrier's code when the route forms part of a through journey to behind and beyond destinations." [16]

5.3 The proposed variation is part of a reciprocal code share arrangement which enables both Qantas and Cathay Pacific to code share on select point-to-point routes to be sold only in conjunction with through journeys (see Table 4 below). For clarity, the application before the Commission does not address Qantas placing its code on seats operated by Cathay Pacific from Hong Kong to points in Australia and vice versa. Qantas' ability to sell Qantas-coded services operated by Cathay Pacific is outside the scope of this application as the Commission's task is only to regulate the allocation of Australian international air services capacity. Under the Australia–Hong Kong air services arrangements, the capacity used by a marketing carrier under code share arrangements is counted against the capacity entitlements of the operating carrier.

[16] Qantas submission, 11 February 2019, pages 2 and 3

Table 4: Qantas-Cathay Pacific code share on select point-to-point routes to be sold only in conjunction with through journeys[17]

Route	Qantas as operating carrier (Cathay Pacific as marketing carrier)	Cathay Pacific as operating carrier (Qantas as marketing carrier)
Brisbane - Hong Kong	QF97 10:10-17:25	CX156 00:55-07:30
Hong Kong - Brisbane	QF98 20:15-07:00+1	CX15713:10-23:35
Melbourne - Hong Kong	QF29 09:40-17:20	CX178 23:45-07:-5 +1
Hong Kong - Melbourne	QF30 20:10-07:35 +1	CX163 11:05-22:05
Hong Kong - Sydney	QF118 22:35-10:00+1	CX139 09:10-20:20

Route in Question

5.4 Section 9(a) of the Minister's Policy Statement requires the Commission to consider the desirability of fostering a competitive environment "on the route in question". Section 4 of the Policy Statement defines a 'route' as:

> "the full set of entitlements available to Australian carriers under a particular bilateral arrangement. All combinations of origin, destination, intermediate and beyond points available to Australian carriers under the bilateral arrangement constitute a single route."

5.5 Qantas seeks to vary the Determination to permit the capacity to be used in accordance with the free-sale code share arrangement between Qantas and Cathay Pacific. The proposed variation would enable Cathay Pacific to market its code on selected services operated by Qantas between Australia and Hong Kong only when used as part of a through journey, that is, only when connecting to a domestic destination within Australia and/ or a behind or beyond international destination.

5.6 Even though the application is not seeking approval of the code share arrangement on 'stand-alone' point-to-point journeys between Australia and Hong Kong, it is an application relating to the use of capacity allocated pursuant to the Australia-Hong Kong bilateral air services arrangement and Australia–Hong Kong is the route in question.

5.7 In view of the issues raised by this application and the submissions received from Virgin Australia and the ACCC, for the purposes of this assessment the Australia–Hong Kong air passenger services market may be helpfully divided into three main segments:

(a) the point-to-point journeys, that is, the final origin or destination is an Australian gateway (e.g. Sydney, Melbourne, Brisbane), flying to/from Hong Kong;

(b) through journey between Hong Kong and an Australian gateway connecting to/from another Australian destination; and

(c) through journey between Hong Kong and an Australian gateway connecting to a point behind Hong Kong, or a point beyond Hong Kong.

[17] Qantas submission, 11 February 2019, page 5; Qantas submission, 15 March 2019, page 5

5.8 Journeys might also occur between Hong Kong and an Australian gateway that both connect to/from another Australian destination and connect to a point behind or beyond Hong Kong (ie what Qantas describes as Zone 1 + Zone 2 + Zone 3 journeys, and vice-versa). The relevant issues raised by such journeys overlap with the issues raised with segments (b) and (c) and are not discussed separately.

a) The point-to-point journeys, that is, the final origin or destination is an Australian gateway, flying to/from Hong Kong

5.9 In its 11 February submission, Qantas stated that the "[p]roposal represents a pro-competitive expansion of each carrier's ability to sell and market itineraries and will not substantially lessen competition on any relevant market"[18]. Qantas further stated in its 15 March 2019 submission, that the proposed variation "will not have any adverse impact on the competitive dynamics on point to point routes between Australia and Hong Kong" as the proposed variation is "focused on attracting connecting passengers who are transiting through Hong Kong to beyond destinations"[19] and that Qantas, Cathay Pacific and Virgin Australia will continue to compete on the point-to-point services.

5.10 In response to this, Virgin Australia stated that "[t]he exclusion of point-to-point itineraries from Qantas' application does not alter the fact that it still encompasses a code share on overlapping routes".[20] Further, in opposing Qantas' application, Virgin Australia highlighted the combined strength of Cathay Pacific and Qantas on the Australia-Hong Kong route. Virgin Australia stated that "[t]he extent of the market power held by Qantas and Cathay Pacific cannot be overlooked in assessing the merits of Qantas' application. Allowing any further concentration of this market power will cement their dominance on the route, at the expense of Virgin Australia and potential new entrants".[21]

5.11 The Commission acknowledges that the proposed variation from Qantas does not seek the Commission's approval of code share arrangements on the point-to-point services between Australia and Hong Kong. However, as the code share conditions would include connecting flights on the trunk route the Commission must remain open to the fact that there may be some competition impacts on these sectors that may be relevant to its assessment. To this extent, the Commission accepts Virgin Australia's view that even though point-to-point services are prohibited under the code share arrangement, the proposal encompasses the point-to-point sectors. These issues are discussed in detail below as the Commission examines the detail of the 'behind and beyond' aspects of the proposed variation.

b) *Through journey between Hong Kong and an Australian gateway (Sydney, Melbourne or Brisbane) connecting to/from another Australian destination*

Examples: Hong Kong – Sydney – Canberra; Hobart – Melbourne – Hong Kong

5.12 The Commission notes that the ability of Cathay Pacific to code share on Australian domestic services does not require Commission approval. In fact, Cathay Pacific already code shares on a range of Australian domestic flights operated by Qantas.

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[18] Qantas submission, 11 February 2019, page 4.
[19] Qantas submission, 15 March 2019, page 4.
[20] Virgin Australia submission dated 28 March 2019, page 4.
[21] Ibid, page 3.

5.13 However, as the proposed variation seeks the Commission's approval for Cathay Pacific to market five point-to-point Qantas-operated services between Australia and Hong Kong when connecting to other Australian (domestic) services operated by Qantas, the competition impact of such an arrangement must be examined.

5.14 It is the Commission's view that the inclusion of a domestic sector in Australia as part of a code share 'through journey' is not, of itself, sufficient to mitigate against any potential competition impacts on the specified flights between Hong Kong and Melbourne/Sydney/Brisbane. The Commission considers that the choice of carrier for the long-haul sector will be driven by factors including flight schedule, frequency, pricing, class of travel and brand loyalty. The availability of a domestic connection in Australia does not significantly differentiate a journey from one between Hong Kong and an Australian gateway. In both cases, the journey's origin and destination points are Australia and Hong Kong.

5.15 The Commission's view is that the competitive environment on the Australia-Hong Kong sectors is relevant to the assessment of the proposed variation given that the applicant is seeking the Commission's approval to use Australia-Hong Kong air services capacity to give effect to this code share arrangement. As previously stated, the Commission accepts Virgin Australia's view that even though point-to-point services are prohibited under the code share arrangement, the proposal encompasses the point-to-point sectors. The Commission must consider whether and, if so, to what extent, the proposed variation impacts the competitive environment on the Australia-Hong Kong route.

5.16 The withdrawal of Hong Kong Airlines in 2018 has left Virgin Australia as the only carrier competing against Qantas and Cathay Pacific in providing direct services between Australia and Hong Kong. In its 26 February submission, Virgin Australia stated that "as a relatively new entrant, the proposed variation would significantly inhibit Virgin Australia's ability to build our presence on the route and to compete with Qantas and Cathay Pacific over the medium to long term"[22]. Virgin Australia also noted that Qantas and Cathay Pacific have been providing services on the Australia-Hong Kong route for 45 years whilst Virgin Australia has only entered on the Melbourne-Hong Kong sector in July 2017 and Sydney-Hong Kong in July 2018[23]. Virgin further stated that "[a]s Virgin Australia's international network footprint is smaller than those of Cathay Pacific and Qantas, reducing our ability to compete effectively on the Hong Kong route will have a proportionately larger impact on our sustainability as an Australian international carrier. This will also limit our ability to both facilitate and capitalise on the projected growth inbound tourist arrivals to Australia."[24]

5.17 The Commission accepts Virgin's submissions about the constraints it faces as the relatively new entrant with a smaller network footprint, and that this effects the competitive environment of the route.

Increased market position of Qantas and Cathay Pacific on the route

5.18 If approved, the proposed variation would permit Cathay Pacific to market and put its code on five more daily flights between Hong Kong and Brisbane, Melbourne and Sydney. This would enable the airline to market 79 weekly services in each direction operated under

[22] Ibid paragraph 5.4, page 6
[23] Ibid paragraph 2.1, page 2
[24] Ibid paragraph 5.5, page 6

its own metal[25] and 35 specific Qantas-operated services per week offered under code share arrangements, resulting in an increase of Cathay Pacific's footprint on the route.[26] Cathay Pacific already operates the full capacity that may be allocated to Hong Kong carriers under the Australia-Hong Kong bilateral air services arrangements to operate services to/from major Australian international gateways (Sydney, Melbourne, Brisbane and Perth). The only way for Cathay Pacific to grow its capacity on the major Australian international gateways under the current restrictions in the bilateral arrangements is to enter into a code share agreement with an Australian carrier.

5.19 Aviation data sourced from BITRE provide the following picture of the market strength of each carrier operating on the Australia-Hong Kong route for the calendar year 2018 (December ended).

Table 5a: Airlines' market share: frequency, seats operated, passengers carried

Airline	Frequency Share*	Seats operated (capacity share)**	Passengers carried (market share of passenger traffic)**
Cathay Pacific	65.3%	63.4%	65.1%
Qantas	23.1%	26.1%	26.4%
Virgin Australia	11.6%	7.9%	6.6%
Hong Kong Airlines (ceased operating at the end of October 2018)	Nil	2.6%	1.9%

*sourced from the International Airlines Timetable Summary, Northern Winter 2018-2019
** sourced from BITRE

Table 5b: Airline load factors on the Australia-Hong Kong route

Airline	Seat utilisation (Load Factor)		
	2016	2017	2018
Cathay Pacific	Inbound: 88.6% Outbound 88.5%	85.0% 85.7%	82.8% 81.5
Hong Kong Airlines*	Inbound: 67.3% Outbound: 67.3%	68.1% 64.3%	58.5% 62.9%
Qantas Airways	Inbound: 81.5% Outbound: 77.8%	79.5% 78.3%	82.3% 78.7%
Virgin Australia	Inbound: 0 Outbound: 0	64.5% 66.2%	66.3% 65.3%

Source: BITRE
*Hong Kong Airlines ceased operating on the route at the end of October 2018

5.20 As Tables 5a and 5b above show, Cathay Pacific and Qantas hold the largest capacity and seat shares between Australia and Hong Kong, with the highest load factors.

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[25] Of those 79, 70 are between Hong Kong and a major Australian international gateway.

[26] This enables Cathay Pacific to market and code a total of 193 flights per week on the route (a total of 158 flights operated under its own metal plus the additional 35 Qantas-operated flights).

5.21 If the proposed variation were approved, it is likely that the code share arrangement between Qantas and Cathay Pacific would enable those two airlines to build on their current combined frequency share of 88.4%; combined seat share of 89.5%; and 91.5% share of total passengers carried (as shown in Table 5a above).

5.22 In assessing the public benefit of the proposed variation, the Commission has had regard to the comparatively recent entry of Virgin Australia as the only other competitor offering direct services on the Australia-Hong Kong route. Since Cathay Pacific and Qantas are established carriers on the route with a following and reputation, the Commission considers it likely that the variation would result in some passengers who may otherwise have purchased a Virgin Australia ticket between Hong Kong and Australia, connecting to another Australian destination, to choose to purchase a Cathay-coded ticket. This added option on a Cathay Pacific code gives a marketing advantage to both Cathay Pacific and Qantas. Therefore, the proposed variation is likely to benefit Cathay Pacific and Qantas to the detriment of Virgin Australia's position in the market.

5.23 Whether measured by the frequency, capacity or market share of passengers carried by the operators of direct services on the Australia-Hong Kong route, it is apparent that Virgin Australia presently has a significantly smaller proportion than either of the other two airlines. If the proposed code share 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. The Commission considers it likely that a material decline in Virgin Australia's market position would cause it to reconsider its service offerings on the route. Any reduction or cessation of Virgin Australia's service offerings on the route would be detrimental to competition as it would then leave the two largest carriers, Qantas and Cathay Pacific, to operate under the proposed code share arrangement.

5.24 The inability of another Hong Kong carrier to serve any of the major Australian international gateways because all capacity entitlements have already been allocated to Cathay Pacific makes it difficult for that other Hong Kong carrier to mount commercially sustainable operations on the Hong Kong-Australia route. Given this capacity restriction on the part of Hong Kong carriers, it is more likely that any competition on the route would come from an Australian carrier. An Australian carrier is only likely to seek to operate on the route if it considers it can do so viably in light of the position of the established carriers.

5.25 If the proposed variation were approved it is likely to strengthen the market position of the two largest carriers on the route. This outcome would make it more difficult for new carriers to enter the route and more difficult for the only other carrier providing competition, Virgin Australia, to sustain a competitive presence on the route.

5.26 The loss of Virgin Australia as an effective competitor on the route is likely to adversely affect the competitive environment on the route to the detriment of consumers. The Commission notes that both Virgin Australia and Qantas referred to the downward pressure on prices that occurred when Virgin Australia began operating on the route. Virgin Australia drew attention to the intense price competition between all three airlines from the commencement of Virgin Australia's services between Melbourne and Hong Kong from July 2017[27]. If Virgin Australia becomes a less effective competitor because of the increased market position of the two largest carriers, this is likely to adversely affect price competition, particular given that the increased market position also means it is less likely any new carrier

[27] Ibid paragraph 2.12 page 4

would enter the route.

5.27 Qantas has not provided any information to the Commission that it will provide additional services as a result of this application. Cathay Pacific is already utilising the full capacity entitlements given to Hong Kong carriers under the bilateral arrangement to operate services to and from the major international gateways in Australia and cannot increase these capacity entitlements. Accordingly, if Qantas and Cathay Pacific's market share increases, and particularly if this leads to Virgin Australia becoming a less effective competitor, then the Commission considers that the limited options for growth or competition risk an increase in airfares on the route.

5.28 The variation is likely to lead to a market structure which makes it more difficult for Virgin Australia to compete and/or raises the 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.

c) ***Through journey between Hong Kong and an Australian gateway (Sydney, Melbourne or Brisbane) connecting a point behind Hong Kong, or a point beyond Hong Kong***

5.29 The through journey between Hong Kong and Sydney, Melbourne or Brisbane connecting a point behind Hong Kong or a point beyond Hong Kong is another element of the proposed variation.

5.30 This aspect of the proposed variation underscores the role of Hong Kong as a regional hub which sees traffic from a range of destinations aggregated onto flights between Hong Kong and Australia. Aviation data from BITRE[28] indicate that while a substantial proportion of the passengers arriving in Australia on the route began their travel in Hong Kong (33.3% of passengers), close to two-thirds of the total traffic carried is connecting from points beyond Hong Kong (66.7%). Much of the connecting traffic comes from China (22.7%), but Hong Kong also provides a useful connection for traffic from other locations, including from India as Qantas emphasised in its submissions.

Table 6 : Arrivals/ Uplift – Hong Kong / Jan-Dec 2018
Australian passenger card data – Department of Home Affairs – prepared by BITRE

Origin	
Hong Kong	33.3%
China	22.7%
United Kingdom	7.6%
Japan	4.0%
India	3.5%
USA	2.8%
Taiwan	2.7%
South Korea	2.0%
Canada	1.7%
Philippines	1.6%
Others	18.1%
Total	**100%**

(Note: Passengers arriving into Australia from a flight that uplifted from Hong Kong, came from the origin destination (country) indicated in the list above.)

5.31 Currently, Qantas does not operate any services from Hong Kong to points other

[28] www.bitre.gov.au / Aviation/ International Airline Activity – Time Series

than Australia.[29] Cathay Pacific, on the other hand, operates to various international destinations from Hong Kong, including Mumbai, Colombo, Delhi, Hyderabad, Chennai, Singapore etc. Qantas currently code shares, as marketing carrier, on these Asian destinations from Hong Kong.[30]

5.32 Qantas has informed the Commission that the international sectors beyond Hong Kong that Cathay Pacific can sell as part of a through journey would be determined by Cathay Pacific and that the code share arrangement between Qantas and Cathay Pacific does not restrict the international destinations to which Cathay Pacific could operate services. On the basis that the international sectors that can be sold by Cathay Pacific in conjunction with an Australia-Hong Kong ticket include unspecified destinations, the range of possible city pairs is limited only by the scope of Cathay Pacific's current and future network.

5.33 The Commission considers that if the proposed variation were granted and Qantas and Cathay Pacific were able to proceed with their reciprocal code share, then, in the absence of the airlines offering additional capacity, it is likely that there would be an increase in demand for services between Australia and Hong Kong, resulting from greater connecting load. The Commission reaches this conclusion on the basis that there would be a proportion of customers for whom the code share arrangement would be beneficial, particularly time-sensitive travellers. However, with an increased demand, the Commission considers it likely that would be a reduced incentive for Qantas and Cathay Pacific to offer the lowest airfares (discounted sale airfares) in the market to fill weaker flights, which would be to the detriment of price-sensitive travellers .

5.34 The Commission considers that the increased demand for Qantas-Cathay Pacific flights between Australia and Hong Kong coming from markets other than purely Australia-Hong Kong (i.e. increased demand comes from the connecting flights) is unlikely to result in Qantas and Cathay Pacific increasing their seats in the same proportion as the increased demand, which is likely to cause their prices to increase. It is likely that in this scenario, some traffic will spill to Virgin Australia. However, given Virgin Australia presently has comparatively low seat utilisation rates, it is unlikely to increase capacity between Australia and Hong Kong (or unlikely to do so in proportion to the increase). This means that the likely result of more demand spilling to Virgin Australia flights is that Virgin would also have less need to discount pricing to generate traffic.

5.35 The Commission's view is that the likely net effect is that while the variation would provide a net benefit to time-sensitive but price-insensitive customers, it is likely to be a net detriment to price-sensitive customers and a net detriment overall.

5.36 The ACCC suggested in its submission of 28 February 2019 that the Commission should look into '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

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29 The Commission understands that under the Australia-Hong Kong air services arrangements, Qantas may operate services from Australia to Hong Kong connecting to certain international destinations, subject to certain conditions

30 International Airlines Timetable Summary, Northern Winter 2018-2019

of competition between the two largest carriers".[31]

5.37 The Commission considers that the likely outcome of increased demand for capacity on the Australia-Hong Kong route generated by the connecting traffic to behind or beyond destinations is that the airlines would offer fewer seats at the lowest (discounted) airfare booking classes. In this situation, 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.

Scheduling and services arrangements

5.38 In its submission to the Commission, the ACCC expressed concern "that the conduct may soften competition in the Australia-Hong Kong air passenger 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"[32].

5.39 In response to this, Qantas stated that "[w]e strongly reject any suggestion that there will be any direct or indirect coordination of price or capacity decisions between Qantas and Cathay under the codeshare (or in any other circumstances). Further to our earlier submission, we reiterate that the Codeshare Agreement between Qantas and Cathay is arms-length and prohibits any form of price, sales, capacity or schedule coordination and we confirm that the arrangement will be implemented in practice in full compliance with all relevant competition laws".[33] Qantas further stated that its "strong contention is that there will not be any softening of competition between Qantas and Cathay on either the point to point routes or on the selling of any through journeys. If this were to occur, Virgin Australia could and would seize the opportunity to respond and capture traffic lost from any artificial price increase or capacity restriction by either Qantas or Cathay." [34]

5.40 The ACCC, in a letter dated 26 March 2019, responded to Qantas' statement and stated that "[t]he ACCC's objective in identifying this as an area for analysis by the IASC was not to allege that there had been or would be collusion in breach of the Competition and Consumer Act 2010. Rather, we were suggesting that the IASC may wish to consider whether the changes to the codeshare would provide an ability and/or incentive for the airlines, acting rationally and taking into account each other's offers, to make independent decisions that would not involve collusion but may nevertheless reduce the intensity of competition between them. This concept is commonly considered by competition authorities and acknowledged in relevant literature. The fact there is a contract that prohibits explicit

[31] ACCC submission, 28 February 2019, page 5
[32] ACCC submission, 28 February 2019, page 5
[33] Qantas submission dated 15 March 2019, page 3
[34] Ibid, page 5

coordination does not fully address this possibility."[35]

5.41 Virgin Australia, stated in its submission of 28 March 2019, that "[w]hile Qantas states that its code share agreement will prohibit any form of schedule coordination, by nature of the timings of the code share services chosen, both Qantas and Cathay in effect receive the benefits of schedule coordination. This is due to the fact that both carriers would have a reduced incentive to re-time their flights to improve connectivity, to the extent that an improved connection is achieved through a code share on the other carrier's service. This is directly relevant to the ACCC's observations....regarding the scope for Qantas' application to result in softening of competition on the route".[36]

5.42 The Commission agrees with the concern identified by the ACCC and Virgin Australia in their submissions. Under the proposed variation there will likely be some benefits for passengers through increased connectivity and reduced connection times. However, in the Commission's view, the very nature of cooperative arrangements between airlines is to maximise the benefits that could be obtained by both parties resulting from the arrangement, in this instance through schedule coordination. The Commission agrees with the ACCC's concern that the proposed code share has the potential to reduce the intensity of competition between Cathay Pacific and Qantas, the largest and second largest competitors, on the Australia-Hong Kong route. The Commission is of the view that vigorous competition between Qantas and Cathay is desirable to foster a competitive environment in the Australia-Hong Kong air passenger services market, and an environment in which Australian carriers can effectively compete, and that the proposed variation would not be conducive to this outcome.

Free-sale code share by airlines operating parallel services

5.43 A proposed code share between two well established airlines with significant market share operating parallel services on the route in question always warrants careful consideration. This approach has been adopted by the Commission previously and similar codeshare applications have also been the subject of comment from the ACCC.

5.44 Virgin Australia has referred to a number of other Commission determinations involving code share arrangements on routes where the airlines operate parallel services (Papua New Guinea, South Africa and Japan) and asserted that these cases "must be taken into account as directly relevant precedent in assessing the merits of the application against the competition criteria".[37]

5.45 Qantas, in its 15 March submission, countered this point and stated that the cases cited by Virgin Australia "are irrelevant to the Commission's consideration of the Proposed Variation" and noted that the current application specifically "excludes the point to point routes".[38]

5.46 The Commission considers that each application must be assessed on its merits, having regard to the nature of that application and the market circumstances relevant to the route in question.

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[35] ACCC submission dated 26 March 2019.

[36] Virgin Australia submission dated 28 March 2019, page 4

[37] Virgin Australia submission, 26 February 2019 paragraph 5.21, page 9

[38] Qantas submission, 15 March 2019, page 6

5.47 The Commission accepts the view expressed by the ACCC in relation to free-sale code share where the code share partners are operating parallel services on the route. The ACCC stated in its 28 February submission that "from a competition perspective, a hard block code share generally is preferable to a free sale code share since it maintains a greater degree of rivalry between the airlines".[39]

5.48 The Commission finds that the free-sale nature of the code share arrangement between the two largest operators on the Australia-Hong Kong route would provide limited incentive for the code share partners to compete on price because the marketing carrier only pays for the seats it sells. Under a hard-block code share arrangement, full commercial responsibility is placed on the marketing carrier for a fixed number of seats so that both the operating and marketing carrier would have the incentive to sell their seats independently of each other, including offering discounted prices.

<u>Conclusion on subsection 9(a)</u>

5.49 Having considered the issues covered above, on balance, the Commission is of the view that:

(a) The proposed variation is likely to strengthen the position of the two largest operators on the Australia-Hong Kong route and heighten the imbalance of comparative strength between the competitors on the Australia-Hong Kong route, given the established market position of Qantas and Cathay Pacific.

(b) The proposed variation is likely to make it more difficult for new entrants to enter the route and mount commercially sustainable operations that would compete with the operations of Qantas and Cathay Pacific. As Cathay Pacific has already been allocated all the capacity entitlements that may be allocated to a Hong Kong designated carrier, it would be especially difficult for another Hong Kong carrier to operate commercially sustainable operations as it will not be able to operate to the major Australian international gateways (Sydney, Melbourne, Brisbane or Perth).

(c) The proposed variation is likely to weaken the competitive position of Virgin Australia, the only other competitor on the route and may do so materially given Virgin Australia is already in a relatively weaker position than the other two airlines. The Commission considers that a material decline in Virgin Australia's market position may cause it to reconsider its service offerings on the route. Given the relative imbalance between the combined Qantas-Cathay Pacific market share and Virgin Australia's market share and the competition history of the route (e.g. Hong Kong Airlines recent withdrawal from the route), the Commission is of the view that even a small but real chance of reduction or cessation of Virgin's operations as a result of the proposed variation means that such approval would not be fostering a competitive environment on the route.

(d) The proposed code share on the through journey connecting points in Australia and Hong Kong to a destination behind or beyond Hong Kong is likely to increase demand on the Australia-Hong Kong route (due to the connectivity traffic). As Qantas is not offering any additional capacity, no additional services can be offered by Cathay Pacific or any other Hong Kong carrier, and Virgin's seat utilisation is relatively low, the effect of increased demand would be to drive up airfares.

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[39] ACCC submission, 28 February 2019, page 5

(e) The free-sale nature of the code share arrangement on parallel services and between the two strongest carriers on the route in question does not shift commercial risk to the carrier holding out the codeshare.

5.50 For the reasons set out above, the Commission finds that, overall, the allocation as varied by the proposed variation would be detrimental to fostering an environment in which Australian carriers can effectively compete with each other and with foreign carriers on the route.

Subsection 9(b): the number of carriers operating on the route in question and the existing distribution of capacity among Australian carriers (including through code sharing and other joint international services)

5.51 Aside from Qantas and Cathay Pacific, Virgin Australia is the only other airline that operates direct services between Australia and Hong Kong. It commenced services from Melbourne to Hong Kong (vice versa) in July 2017 and the following year, in July 2018, commenced services from Sydney to Hong Kong (vice versa). As Virgin Australia indicated in its submission of 26 February 2019, its international network footprint on the Australia-Hong Kong route is still developing and is smaller compared to Qantas and Cathay Pacific.

5.52 As previously discussed, allowing Cathay Pacific and Qantas, the two dominant carriers with the largest capacity allocations on the Australia-Hong Kong route, to code share would further strengthen their position on the route making it more difficult for another carrier to enter. This position is exacerbated by the absence of capacity for a new entrant from Hong Kong to serve the major gateways of Australia (Brisbane, Melbourne including Avalon, Sydney and Perth) as the capacity entitlements to operate to and from these major gateways have all been allocated to Cathay Pacific.

5.53 The Commission considers that, based on its experience and having regard to the submissions it has received, a greater number of carriers providing services on a route may be expected to result in greater benefit to the public through factors such as increased competition, improved service offerings, and lower prices. As the Commission has noted above, and as both Qantas and Virgin have stated, there is evidence that there was downward pressure on prices when Virgin Australia entered the Australia-Hong Kong route. The Commission has found that the proposed variation would entrench the dominant positions of Qantas and Cathay Pacific as the two largest airlines offering direct services on the route. On balance, for the reasons outlined under subsection 9(a) above, the Commission considers that this further entrenched position is likely to impair other carriers' ability to enter into and offer commercially sustainable services on the route.

5.54 Virgin Australia stated in its 26 February 2019 submission that "[c]ompetition on the Hong Kong route from third country carriers is extremely limited".[40] The Commission notes that services offered by third country airlines between Australia and Hong Kong (which necessarily require at least one stop-over) are understandably a less attractive proposition. Transiting via a third country necessarily takes a longer flight time. The block time of a nonstop flight between Sydney and Hong Kong is typically 9 hours and 30 minutes. Connections via Singapore (operated by Singapore Airlines) range from 13 to 17 hours, with longer times via other city hubs and with other carriers. Indirect competition on the route

[40] Virgin Australia submission, 26 February 2019, paragraph 2.13, page 4

from third country carriers is accordingly limited.

5.55 The public interest is best served by having a healthy number of competing carriers on the route, each with a sustainable level of capacity. The proposed variation is likely to create a further impediment to new entrants on the route, weaken one of the Australian carriers, and has the potential to lead to the exit of one of the Australian carriers.

Subsection 9(c): 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

5.56 The Commission draws on its analysis set out under subsection 9(a) in considering this subsection.

5.57 The proposed variation enables Cathay Pacific to market and offer under a single (Cathay Pacific) code a flight between Australia and Hong Kong operated by Qantas as part of a through journey that connects to a behind or beyond flight operated by either Qantas or Cathay Pacific. The Commission accepts that there will be some positive impact on consumers, particularly highly time-sensitive consumers, from an expansion of opportunities to be able to purchase a ticket on a through journey under a Cathay Pacific code, giving the passengers the benefit of an additional option on how they wish to travel. It is to be noted, however, that passengers are able to connect to various destinations behind and beyond Australia or Hong Kong under existing cooperative arrangements currently in place between Qantas and Cathay Pacific[41]. To illustrate, passengers are able to purchase a through ticket from Australia to behind or beyond destinations under any of the following options:

(a) under a single Qantas code on a flight where the Australia-Hong Kong segment is operated by Qantas and the beyond destination from Hong Kong is operated by Cathay Pacific or Hong Kong Dragon Airlines (Cathay Dragon), a subsidiary of Cathay Pacific ; or

(b) under a single Cathay Pacific code on a flight operated by Cathay Pacific from an Australian international gateway to a destination beyond Hong Kong; or

(c) under a single code offered by Qantas on a flight where all segments from an Australian gateway to beyond destinations are operated by Cathay Pacific; or

(d) under one ticket with two or more airline codes on the basis of interline arrangements between the relevant airlines.

5.58 The Commission considers that while Cathay Pacific, under the proposed variation, would be able to offer a wider range of departure time choices to their customers, the short-term consumer benefit of some additional through code connectivity is likely to be outweighed by the negative impacts that the likely reduced competition on the route would have on consumers.

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[41] The Commission notes that Virgin Australia also provides connectivity to passengers travelling from Australia to various destinations via Hong Kong through its code share and interline arrangements with certain airlines.

5.59 Qantas stated that the proposed code share would provide "improved customer benefits to members of each carrier's loyalty programs, with Qantas Frequent Flyer members earning more Qantas Points and status credits when travelling on the Qantas-coded flights and Cathay Pacific Marco Polo Club members earning more Club Points when travelling on a Cathay-coded flight".[42]

5.60 The Commission observes that, as Qantas and Cathay Pacific are airline partners under the oneworld alliance, their respective frequent flyer customers can earn frequent flyer points and rewards when flying with either airline, even without a code share arrangement in place between them.[43] To the extent that the variation would lead to certain customers being awarded a greater number of frequent flyer points than under present arrangements, this reflects an internal administrative decision of the airlines as to the circumstances in which frequent flyer points are allocated in that scenario rather than such points being offered as an additional product differentiation or innovation to customers to attract their business that would be implemented as a result of the proposed variation.

5.61 Qantas indicated that the code share agreement is not exclusionary, which means that the arrangement does not prohibit either carrier from entering into commercial partnerships with other carriers. However, given the existing alliance arrangements of the airlines providing direct services on the route, the Commission considers that Cathay Pacific would be unlikely to enter into a code share arrangement with Virgin Australia.

5.62 Qantas indicated in its submission of 11 February 2019 that the proposed code share will provide more route options on each of Qantas' and Cathay Pacific's behind and beyond networks. This will expand each carrier's network and their economies of scope and density. Economies of scope will be achieved as the code share arrangement will enable Qantas and Cathay Pacific to 'serve' new markets without incurring operational costs.[44] While the Commission accepts that the broader code share arrangements between Qantas and Cathay Pacific would provide more route options to consumers, the Commission considers that this would likely be outweighed by the negative impacts on customers that are likely to follow from the reduced competition on the route.

5.63 The Commission considers that while Cathay Pacific, under the proposed variation, would be able to offer a wider range of departure time choices to their customers, it is likely to be at the expense of lessening competition on the route, which will detrimentally impact on consumers in the medium to long term. Therefore the Commission is of the view that the negative impact that the variation is likely to have on competition would have detrimental effects on consumers that are likely to outweigh the short-term consumer benefit of some additional scheduling options. As discussed in paragraph 5.57 above, the Commission notes that all of the additional connectivity proposed is already available on an interline or code share basis between Qantas and Cathay Pacific, and can be sold through on the Qantas code.

5.64 Therefore, overall, the Commission considers that while the variation is likely to result in a minor benefit of increased convenience for consumers, this is likely to be outweighed by detrimental impacts on consumers including increases in airfares, and potentially reduced customer choice and product differentiation due to the worsened competitive environment on the route. The variation is unlikely to stimulate innovation by the

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[42] Qantas submission, 11 February 2019, page 5.

[43] https://www.qantas.com/fflyer/dyn/flying/earning-points-partner-airlines

[44] BITRE, Working Paper 21, Code Sharing in International Aviation: a Discussion Paper, page 13.

incumbent carriers or to lead to increased frequency of services on the route.

Subsection 9(d): the desirability of fostering own aircraft operations by Australian carriers over code share or other joint international air services involving the marketing, by an Australian carrier, of seats on flights operated by foreign carriers

5.65 The Commission did not consider this criterion to be relevant because the variation sought does not raise a choice between fostering own aircraft operations as against the marketing, by an Australian carrier, of seats on flights operated by foreign carriers.

Subsection 9(e): the benefits of allocating the capacity to a given applicant over other competing applicants, having regard to any commercial arrangements that may be in place with other carriers.

5.66 The Commission did not consider this criterion to be relevant because there are no 'competing applicants' for the capacity in question.

Subsection 9(f): any determinations, decisions or notifications made by the ACCC, or any determinations made by the Australian Competition Tribunal, in relation to an Australian carrier using capacity in all or part of the route.

5.67 The Commission did not consider this criterion to be relevant as neither the ACCC nor the Australian Competition Tribunal has made any determination, decision or notification concerning an Australian carrier using capacity in all or part of the route. The ACCC did make submissions to the Commission concerning the proposed variation, which are considered throughout this decision where relevant.

Subsection 9(g): any determinations, decisions or notifications made by a foreign agency that performs a comparable function to the ACCC or the Australian Competition Tribunal, or by a foreign aeronautical authority, in relation to a carrier using entitlements under a bilateral arrangement on all or part of the route.

5.68 The Commission notes that Qantas has obtained the approval from the Director-General of Civil Aviation of Hong Kong to enable Qantas to code share, as marketing carrier, on flights operated by Cathay Pacific on the following routes:

Table 7: Qantas-Cathay Pacific code share approvals

Operating carrier	Marketing carrier	Code share route	Effective Date
Cathay Pacific	Qantas	HKG-BOM (Mumbai)	28 October 2018
Cathay Pacific	Qantas	HKG-CMB (Colombo)	28 October 2018
Cathay Pacific	Qantas	HKG-CNS (Cairns)	28 October 2018
Cathay Pacific	Qantas	HKG-DEL (Delhi)	28 October 2018
Cathay Pacific	Qantas	HKG-MAA (Chennai)	28 October 2018
Cathay Pacific	Qantas	HKG-PER (Perth)	28 October 2018

Cathay Pacific	Qantas	HKG-SGN (Ho Chi Minh)	28 October 2018
Cathay Pacific	Qantas	HKG-ICN (Incheon)	31 March 2019
Cathay Pacific	Qantas	HKG-NGO (Nagoya)	31 March 2019
Cathay Pacific	Qantas	HKG-CTS (Hokkaido)	31 March 2019
Cathay Pacific	Qantas	HKG-BNE (Brisbane)	31 March 2019
Cathay Pacific	Qantas	HKG-MEL (Melbourne)	31 March 2019
Cathay Pacific	Qantas	HKG-SYD (Sydney)	31 March 2019

5.69 The Commission notes that the code shares listed in the above table will not be utilising Australian capacity and, as previously indicated, the code shares are outside the scope of the proposed variation before the Commission. It is, however, noted that the Commission has had regard to these code share approvals by the DGCA in its consideration of the criterion in subsection 9(i) and the likely future without the proposed variation.

Tourism and trade criteria

Subsection 9(h): the level of promotion, market development and investment proposed by each of the applicants

5.70 The Commission did not consider this criterion to be relevant because there is no information before the Commission to indicate that the proposed variation would affect the level of promotion, market development or investment by Qantas in relation to tourism or trade.

5.71 Qantas indicated in its 11 February 2019 submission that the proposed variation and broader code share arrangements provide convenient round-trip connectivity from Australia to various Asian cities via Hong Kong which would "impact not only on consumer choice but on broader Australia-India tourism, trade and business flows"[45]. The issue of providing connectivity to various Asian destinations, particularly India, is discussed further in the Commission's consideration of subsection 9(i) below.

Subsection 9(i): route service possibilities to and from points beyond Australia or foreign gateways

5.72 Qantas stated the following in its submission of 11 February 2019:

> "Under the reciprocal arrangements, Qantas can now offer convenient round-trip connectivity via Hong Kong to five code share destinations in India (Mumbai, Delhi, Bangalore, Chennai and Kolkata) and to one destination in Sri Lanka (Colombo). These five Indian markets cover 76 per cent of all Australia to India origin/destination traffic, whilst Colombo, as the country's key gateway, accounts for all Australia to Sri Lanka traffic.
>
> This connectivity via Hong Kong and enhanced consumer choice would not be possible absent the Proposal and broader code sharing arrangements. In

[45] Qantas submission, 11 February 2019, page 7

circumstances where Qantas does not operate to India, the commercial arrangements with Cathay and Cathay Dragon foster an environment in which Qantas can more effectively compete with large established operators.

The ability for Qantas to offer a maximum range of itineraries beyond Hong Kong to India is particularly critical given the risk to Qantas' ability to offer code share route options on Jet Airways and loss of interline options on both Jet Airways and Air India as a result of changes to these carriers' distribution platforms (from 1 April 2019 and 4 December 2018 respectively). These changes will impact Qantas' ability to offer a more comprehensive India network to consumers.

The reduced ability to offer the Jet Airways and Air India networks will have an impact not only on consumer choice but on broader Australia-India tourism, trade and business flows. This makes the Proposal and broader code sharing arrangements critical to enable Qantas to continue to sell and market destinations in India."[46]

5.73 In addressing subsection 9(i), the Commission notes that the proposed variation adds no new connectivity between Australia and points beyond or behind Hong Kong.

5.74 As previously discussed under subsection 9(c), the existing code share arrangements between Qantas and Cathay Pacific already enable connections to various destinations (other than mainland China or Taiwan) via Hong Kong on flights where Qantas code shares as the marketing carrier on Cathay Pacific-operated services. Broader connectivity is enabled through interline arrangements between Qantas and Cathay Pacific under the oneworld alliance. Passengers flying on Cathay Pacific-operated flights from destinations including India, Korea, and Vietnam can connect to Australia on a:

- flight operated by Cathay Pacific, on a Cathay code; or
- flight operated by Cathay Pacific, on a Qantas code; or
- flight operated by Qantas, on a Qantas code.

5.75 As previously discussed, the existing code share arrangement of Qantas with Cathay Pacific enables Qantas to market its code on Cathay Pacific-operated services between Australia and Hong Kong; as well as points beyond or behind Hong Kong. Under this code share arrangement, Cathay Pacific may put its code on Qantas-operated services between Australian domestic ports (which it may already do without Commission approval).

5.76 Under the Australia-Hong Kong air services arrangements, Qantas does not require the Commission's approval in order for Qantas to provide code share services, as marketing carrier, on flights operated by Cathay Pacific. The Commission notes that Qantas currently code shares on flights operated by Cathay Pacific between Hong Kong and Cairns/Perth and from the Northern Summer 2019 scheduling period (commencing on 31 March 2019), it is expected that Qantas would commence code sharing on Cathay Pacific flights between Hong Kong and Brisbane, Melbourne and Sydney, as approved by the relevant regulatory authorities.

5.77 The Commission further notes that Qantas currently code shares, as marketing carrier on various flights operated by Cathay Pacific from Hong Kong to Chennai, Delhi, Hyderabad and Mumbai in India, to Colombo (Sri Lanka) and to Ho Chi Minh (Vietnam).

[46] Qantas submission, 11 February 2019, pages 6-7.

Qantas also code shares, as marketing carrier, on flights operated by Cathay Dragon from Hong Kong to Bangalore and Kolkata in India, to Yangon (Myanmar) and to Da Nang and Hanoi (Vietnam).[47] All of these code share arrangements are permitted under the relevant air services arrangements, and are currently in force and effect, without the need for an approval from the Commission.

5.78 Apart from the option for Cathay Pacific to sell Cathay Pacific coded connections for a small number of less frequently served behind points (for example, Jinan in mainland China) that already connect on an interline basis to the Qantas services, the Commission's view is that the Qantas application does not add new services or new connectivity between Australia and various destinations via Hong Kong. No new point in Australia or Asia would be connected that is not already available under interline or code share arrangements between Qantas and Cathay Pacific or Cathay Dragon. Qantas confirms in its submission of 9 April 2019 that the beyond destinations are not new. Qantas stated that "[w]hat is new is the ability to connect to these destinations within a maximum connection time of four hours (considered standard practice for determining a reasonable connection that would be acceptable to consumers)"[48]. Qantas listed examples of itineraries where connectivity (using only the Cathay Pacific code) will be shorter.

5.79 Qantas emphasised in its submissions the need for it to develop a range of itineraries to Indian destinations via Hong Kong because of the loss of interline options on Jet Airways and Air India, and recent service cancellations by Jet Airways as a result of the financial pressure it is under. For the reasons explained above, Commission does not consider that the variation would lead to any increase in the itineraries available compared to the connections currently available.

5.80 Having regard to the above, the Commission accepts that there would be some limited connectivity benefits from allowing Cathay Pacific to offer through journeys on a single airline code, using a code share on selected Qantas flights between Australia and Hong Kong. The net effect on route service possibilities from the variation would be limited.

Subsection 9(j): the availability of frequent, low cost, reliable air freight movements for Australian importers and exporters

5.81 Both Qantas and Cathay Pacific operate dedicated freight services between Australia and Hong Kong. Qantas operates one weekly freight service between Sydney and Hong Kong using a Boeing 767-300 freighter aircraft. Cathay Pacific operates two weekly services using a Boeing 747 freighter aircraft. Additionally, Federal Express (Fedex) operates one weekly freight service connecting Honolulu, Sydney and Hong Kong.[49]

5.82 The Commission notes that the proposed variation does not increase the dedicated freight services currently being operated by Qantas and Cathay Pacific. Additionally, as the proposed variation does not increase the frequency of passenger flights operated by either Qantas or Cathay Pacific, there will be no additional freight capacity as a result of the proposed variation. Therefore, the Commission did not consider this criterion to be relevant.

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47 International Airlines Timetable Summary, Northern Winter 2018-2019

48 Qantas submission, 9 April 2019, page 1.

49 International Airlines Timetable Summary Northern Winter 2018-2019

Relevant information obtained from Government Agencies

Subsection 9(k): any information that the Commission has obtained from Australian Government agencies or statutory authorities that the Commission considers to be relevant

5.83 The Commission has had regard to information obtained from BITRE in relation to the route, which it has referred to where relevant throughout the draft decision. It has also considered the submissions of the ACCC, referred to throughout this document.

Subsection 9(l): any other matter or consideration that the Commission considers to be relevant

5.84 With the exception of the matters discussed under the heading immediately below, the matters that the Commission considers to be relevant are discussed under the headings above.

Likely future without the proposed variation

5.85 In its submission of 28 February 2019, the ACCC stated that it "will be important for the IASC to consider the likely future without the Proposed Variation in its assessment of any potential competitive harm"[50]. The Commission agrees.

5.86 The Commission considers that in the absence of approval of the proposed variation, Qantas and Cathay Pacific would remain able to code share and implement elements of the updated annex. Cathay Pacific would remain able to code share on Qantas' domestic services in Australia. Qantas would remain able to code share on Cathay Pacific-operated services beyond Hong Kong, subject to the limitations provided in the relevant bilateral air services arrangements. However, Cathay Pacific would not be able to add its code on Qantas-operated services between Hong Kong and Sydney, Melbourne or Brisbane.

5.87 The Commission notes that Qantas is already able to place its code on Cathay Pacific services from Hong Kong to Brisbane, Cairns, Melbourne and Perth, vice versa and from Hong Kong to Sydney.[51]

5.88 The Commission further notes that Qantas is able to put its code on services operated by Cathay Pacific and its subsidiary, Cathay Dragon from Hong Kong to various destinations in India, Japan, Korea, Myanmar, Singapore, Sri Lanka and Vietnam.[52]

5.89 The Commission has had regard to Qantas' submission that "if the Proposed Variation is not approved, the ability of Qantas to code share on Cathay operated Zone 2 sectors would be placed at risk and subject to further discussions between the carriers"[53]. Qantas has further commented to the Commission that "it should not be assumed that the counterfactual position in the absence of approval of the Proposed variation would be the implementation of Qantas' code on selected Cathay operated services between Hong Kong

[50] ACCC submission, 28 February 2019, page 4
[51] Northern Summer 2019 International Airlines Timetable Summary (31 March 2019-26 October 2019)
[52] Ibid.
[53] Qantas submission, 15 March 2019, page 4.

and Sydney, Melbourne, Brisbane for the purposes of through journeys." Qantas did not, however, suggest what assumptions the Commission should make as to the counterfactual position.

5.90 If the proposed variation were rejected, what appears to be potentially put at risk of renegotiation with Cathay Pacific are the code share arrangements in relation to Zone 2 sectors—i.e., the point-to-point services between Australia and Hong Kong.

5.91 The Commission is of the view that Qantas and Cathay Pacific are unlikely to renegotiate the code share arrangements on the Qantas-operated (Australian) domestic services. As the Commission noted earlier, Cathay Pacific does not, and is not allowed to, operate domestic services in Australia and its code share arrangements on Qantas' Australian domestic services provide an important connectivity to its passengers travelling within Australia.

5.92 Likewise, the Commission considers that code share arrangements which enable Qantas to market and code on flights operated by Cathay Pacific and Cathay Dragon from behind or to beyond Hong Kong destinations are unlikely to be disturbed. The Qantas code would be expected to feed more traffic into these Cathay-operated flights and would not make commercial sense if these code share arrangements were withdrawn.

5.93 The Commission is of the view that if there was a renegotiation of any part of the code share arrangements, it is likely to be of that part that allows the airlines to place their codes on each other's services between Hong Kong and Sydney, Melbourne or Brisbane.

5.94 Qantas identifies the easier marketing of complex itineraries on a single airline code as a justification for the proposed variation. As the Commission discussed in subsections 9(c) and 9(i), Qantas already has the ability to code share on a range of Cathay Pacific flights beyond Hong Kong. It is therefore already possible for Qantas to market under a single airline code on these services from Australia to various international destinations through Hong Kong. The marketing of complex itineraries is therefore not dependent on the approval of this application.

5.95 Furthermore, the Commission notes that Qantas and Cathay Pacific are able to sell each other's services under arrangements in place between member airlines of the oneworld alliance. Opportunities for beyond point connectivity on a single ticket through Hong Kong are available to both airlines even without the proposed variation.

5.96 As the ACCC noted in its submission of 28 February 2019, without the proposed variation, each airline would utilise the capacity allocated to them by the Commission and the IASC-equivalent in Hong Kong. The airlines would add capacity, taking up unallocated capacity, depending on growth in passenger demand and the competitiveness of their offering. The Commission considers this situation fosters a competitive environment in which Australian airlines can effectively compete with each other and with foreign carriers on the route.

5.97 Likewise, as noted by the ACCC, without the proposed variation Virgin Australia would continue to operate and market services between Australia and Hong Kong and market through journeys to other destinations via Hong Kong under its code share and interline arrangements with other airlines.

5.98 Finally, the Commission considers that as Cathay Pacific is already exercising the full capacity entitlements available under the Australia – Hong Kong bilateral arrangement, any growth in Hong Kong – Australia traffic would more likely flow to services operated by Australian carriers. This outcome would be consistent with the object of the Act which is to enhance the welfare of Australians by promoting economic efficiency through competition in the provision of international air services resulting in, among others, the maintenance of Australian carriers capable of competing with airlines of foreign countries.

6 Summary of the Commission's findings

6.1 The Commission finds that it is likely that the variation would result in some consumer benefits in terms of improved connectivity and potentially some increase in route options.

6.2 However, the Commission also finds that the variation is likely to entrench and expand the market position of Qantas and Cathay Pacific, to the detriment of Virgin Australia's competitive position and the position of any potential future entrants on the route. If this occurs, it is likely to weaken competition on the route, leading to an increase in prices and/or a reduction in other benefits to consumers.

6.3 Qantas identifies the easier marketing of complex itineraries on a single airline code as a key benefit to the public that would result from the proposed variation. The Commission has found, however, that Qantas already has the ability to code share on a range of Cathay Pacific flights beyond Hong Kong, connecting to the same aircraft that the application seeks approval for. It is, therefore, already possible for Qantas to offer a single airline code on these aircraft through Hong Kong to Australia. Codeshare and interline arrangements between Qantas and Cathay Pacific are already in place giving Cathay Pacific the ability to offer through-journey connectivity to passengers from Australia to various destinations via Hong Kong and vice versa. The marketing of complex itineraries is not dependent on the approval of this application.

6.4 The Commission also found that without the proposed variation, Qantas is able, under codeshare arrangements currently in place, to market its code on a range of services operated by Cathay Pacific and Cathay Dragon to various destinations in Asia, including cities in India, Vietnam, and Korea.

6.5 The Commission finds that the likely public benefits of the variation are substantially outweighed by the likely public detriment that would follow from the proposed variation. For this reason, the Commission is satisfied that variation would not be of benefit to the public, within the meaning of the Act. Accordingly, the Commission must not make a decision approving the variation.

7 Decision ([2019] IASC 204d)

7.1 In accordance with section 25 of the Act, the Commission, having conducted a review, proposes to make a decision not to vary Determination [2015] IASC 115 which allocates capacity to Qantas on the Hong Kong route, in the manner requested by Qantas.

7.2 This decision comes into effect from the date of issue.

Dated: 24 May 2019

IAN DOUGLAS
Chairperson

JAN HARRIS
Commissioner

KAREN GOSLING
Commissioner

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