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

Via Fax: (02) 6267 1111

Dear Ms McIntosh *Sue*

Re: Review of code share arrangements between Qantas and South African Airways

I refer to the application lodged by Qantas Airways on 18 August 2011 concerning the above matter and my letter of 26 August indicating Virgin Australia's intention to comment on the application.

This submission does not constitute an objection to the Qantas application, but makes a number of observations in relation to it.

The Virgin Australia Group of airlines successfully operates international services to 11 countries, having grown from a relatively low initial weekly frequency in each market. V Australia has expanded B777 services on the Los Angeles route to 14 per week since introducing three weekly services in February 2009. As recently reported in Virgin Australia's 2010/11 financial results, our international operations are profitable.

V Australia launched twice-weekly B777 services between Melbourne and Johannesburg in March 2010, with a third service being added in December 2010. Consumers responded positively as fares offered by direct carriers fell markedly across all classes. It became apparent, however, that the competitive imbalance created by the established Qantas-SAA arrangements would not support the profitable deployment of the V Australia aircraft on the route. The combined double daily frequencies and associated cooperative marketing activities of Qantas and SAA would have required a substantial presence by V Australia in order to be viable. In announcing the withdrawal of V Australia's services from February 2011, Chief Executive Officer John Borghetti stated that "As a minor player on the African route, the prospects of achieving a return are remote".

Qantas' application emphasises the importance of third country carriers in the Australia-South Africa market. While these carriers offer fares over hubs in Asia and the Middle East, the comparative journey times mean that they are only a genuine competitive influence in the leisure segment of the market. Flying via Singapore with Singapore Airlines, the most significant third country competitor on the route with a market share of around eight percent in 2010/11, increases travel time between Sydney and Johannesburg by seven hours or 50 percent and adds 10 hours or 100 percent to a Perth-Johannesburg journey, relative to the non-stop flights operated by Qantas and SAA respectively. The value placed on the reduced travelling time of a direct service is reflected in the relative average pricing offered on the route by direct and indirect carriers respectively.



Qantas suggests that "traffic rights restrictions in the air services agreement ensure limited commercially viable hub opportunities for Qantas code share services with the exception only [sic] of New Zealand" (p1). Virgin Australia notes that the air services arrangements provide for code share services to any points beyond South Africa or Australia with full fifth freedom rights provided a commercial agreement has been concluded between an Australia and a South African carrier. That is, cooperative marketing between Qantas and SAA would be possible over Johannesburg and Sydney to any points on each other's networks (third country air services agreements permitting). That this does not occur is a commercial decision by the carriers, as opposed to a regulatory barrier as stated in Qantas' submission.

It is also worth noting that these traffic rights restrictions do represent impediments to Virgin Australia's ability to code share with third country carriers between Australia and South Africa over intermediate points, eg Etihad Airways and Singapore Airlines.

Qantas' submission states that "Behind the gateway points Qantas and Virgin compete for SAA beyond traffic within the Australian, South African and New Zealand markets." (p5) This is incorrect. While the Virgin Australia Group has an interline arrangement with SAA, it has been inactive since V Australia withdrew services to Johannesburg in February 2011. In addition, as the Virgin Australia-SAA interline arrangement is unilateral, Virgin Australia does not sell any SAA traffic beyond Perth to any of these three markets.

Qantas' request to the Commission to extend the arrangements appears to be largely supported by a claim that the route has special characteristics. Virgin Australia would argue that the code share arrangements are themselves a characteristic of the route that represents a material influence on its competitiveness and the public benefits derived.

Qantas suggests that the counterfactual would see the route served by a single direct carrier (p3). Virgin Australia regards such a scenario as highly improbable, and would expect the withdrawal of either Qantas or SAA to attract a new Australian or South African entrant. The route offers a relatively balanced mix of inbound and outbound travellers, and a solid business component driven by the mining sector that assists in offsetting the seasonal nature of the leisure segment. However, in Virgin Australia's view, over time the Qantas-SAA arrangements will act as a competitive deterrent to aspiring new entrants given the limited prospects for sustainable operations on the route.

We note that Qantas' application does not indicate a commitment to operate a minimum level of frequencies as part of the code share arrangements, either in its own right or in combination with SAA. It is not clear how public benefits could be assured absent such an undertaking.

Against this background, should the Commission decide to extend authorisation for the Qantas-SAA arrangements, Virgin Australia would caution it against doing so for a period of five years.

The Commission may also wish to consider options for injecting greater competition into the arrangements in order to produce greater public benefits, such as conditions tied to the size of the hard blocks purchased by the carriers on each other's flights.

Yours sincerely

A handwritten signature in black ink that reads "Jane McKeon".

Jane McKeon
Group Executive
Government Relations