Virgin australia

5 October 2012

Mr Christopher Samuel
Senior Adviser
International Air Services Commission
PO Box 630
Canberra ACT 2601

Dear Mr ~~Samuel~~ Chris

Re: Application for capacity allocation – Italy route

I refer to your letter of 12 September 2012 inviting Virgin Australia to provide a submission addressing the paragraph 8 criteria of the Minister's Policy Statement in support of our application for an allocation of 300 seats per week on the Italy route, which was lodged with the Commission on 11 September.

Please find Virgin Australia's submission enclosed with this letter.

We note that on 27 September the Commission granted Qantas Airways (Qantas) an extension to lodge its submission in relation to this matter, on the basis that Qantas indicated that its proposed partnership with Emirates Airlines (Emirates) will include points in Italy and is therefore relevant to its application for renewal of Determination [2007] IASC 113. While Virgin Australia's submission has been prepared in response to Qantas' application of 3 September for renewal of the capacity to support code share services with Cathay Pacific and your letter referred to above, the central arguments which underpin our submission are not specific to Qantas' code share services with Cathay Pacific. In fact, given Emirates' strong presence on the Italy route, cooperative marketing arrangements have the potential to strengthen Qantas' dominant position. This underscores the public benefits that will be realised through enhanced competition with the introduction of services on the route by Virgin Australia as a new entrant.

In accordance with your letter of 12 September, Virgin Australia expects to have the opportunity to lodge a supplementary submission in response to Qantas' submission, particularly as it will contain new material that relates to its proposed alliance with Emirates. Given the change in timeframes brought about by the extension sought by Qantas, we look forward to receiving further advice regarding revised timeframes for the lodgement of this supplementary submission.

We would be pleased to provide the Commission with any additional information it may require to assess our application.

Yours sincerely

Jane McKeon

Jane McKeon
Group Executive
Government and International Relations

VIRGIN AUSTRALIA

SUBMISSION IN SUPPORT OF AN APPLICATION FOR THIRD COUNTRY CODE SHARE CAPACITY ON THE ITALY ROUTE

Virgin Australia International Airlines Pty Ltd (Virgin Australia) is applying for 300 of the 600 seats per week of third country code share code capacity allocated to Qantas Airways Ltd (Qantas) on the Italy route under Determination [2007] IASC 113, pursuant to section 12(3) of the *International Air Services Commission Act 1992* (Cth) (the Act). Qantas has applied to the International Air Services Commission (the Commission) for renewal of this determination for five years from 8 August 2013.

The capacity sought by Virgin Australia will be used to introduce code share operations on both Etihad Airways' (Etihad) and Singapore Airlines' flights on the route and will be fully utilised as soon as all necessary regulatory approvals have been secured. The implementation of code share services to Italy is a high commercial priority for Virgin Australia. Traffic volumes on the Australia-Italy route are the fourth highest in terms of European markets after the United Kingdom, Germany and France,[1] which is reflected in the strong levels of interline traffic that Virgin Australia currently sells on the route.

There are 1,000 seats per week of capacity for code sharing with third country carriers under the Australia-Italy air services arrangements, with the full quantum of capacity allocated to Qantas. Despite concerted efforts by the Commonwealth Department of Infrastructure and Transport on Virgin Australia's behalf, it has not been possible to secure additional third country code share capacity under these arrangements.

Paragraph 8 of the *International Air Services Policy Statement No.5* (Cth) (Minister's Policy Statement) outlines the criteria relevant to an assessment of the benefit to the public in relation to applications for renewal of determinations, in circumstances where capacity is limited under air services arrangements. These criteria are dichotomised according to whether or not a route is in the start up phase. Paragraph 8.1(a) provides that during the start up phase on a route, the criteria contained in paragraph 7 are applicable "...to that part of the capacity which is reasonably necessary for a level of scheduled international services necessary to permit the development of efficient commercially sustainable operations", while the criteria in paragraph 8.1(b) apply to the balance of the capacity.

The Italy route is currently in the start up phase and the 300 seats per week of capacity sought by Virgin Australia is the minimum capacity reasonably necessary to introduce a level of scheduled international services capable of facilitating the development of an efficient and commercially sustainable code share operation. Therefore, in accordance with paragraph 8.1(a), this application should be assessed by reference to the criteria for routes in the start up phase provided in paragraph 7 of the Minister's Policy Statement.

Italy route – the start up phase

The criteria relevant to Virgin Australia's application are those which relate to the start up phase, the application of which to the Italy route is substantiated below.

[1] Department of Immigration and Citizenship – Origin and Destination movements FY12.

Paragraph 7.1 provides that, "[w]here capacity is limited under a bilateral arrangement, during the start up phase in relation to any route on which an Australian carrier is already operating scheduled international services, the pre-eminent consideration is to introduce competition on the route through the allocation to an initial new entrant of sufficient capacity to develop an efficient and commercially sustainable operation".

The "start up phase" is defined under paragraph 2 of the Minister's Policy Statement as meaning, "...in relation to any route, the period from 1 July 1992, or from such later date as a particular bilateral arrangement becomes subject to the Act in order that available capacity under that arrangement may be allocated by the Commission, until the date on which a determination has been made under the *[sic]* section 7 or 8 of the Act allocating a commercially sustainable level of capacity on the route to a new entrant".

Paragraph 2 defines "new entrant" as meaning, "...in relation to a route, an Australian carrier that has not previously been allocated a commercially sustainable level of capacity in relation to that route". "Commercially sustainable level of capacity" is also defined under this paragraph as meaning "...the minimum capacity necessary to permit the development of efficient commercially sustainable operations on a route".

Capacity for third country code share services is limited under the Australia-Italy air services arrangements, with 1,000 seats per week available to carriers of both countries. The Australian entitlement is held in its entirety by Qantas under Determinations [2007] IASC 113 (600 seats per week) and [2010] IASC 104 (400 seats per week) to support the operation of international code share services on the route with Cathay Pacific via Hong Kong and British Airways via Singapore and London respectively.

Virgin Australia is a "new entrant" as it has not previously been allocated any capacity on the Italy route.

A route will remain in the start up phase until the date on which a determination is made under section 7 or 8 of the Act allocating a commercially sustainable level of capacity to a new entrant. It is important to note that only a determination which allocates *a commercially sustainable level of capacity* will be effective to acquit the start up phase on any route. If a determination is made in favour of an airline that has not previously held an allocation of capacity on a particular route, but it cannot be established that the determination allocates a commercially sustainable level of capacity, the route will remain subject to the start up phase and new entrants will continue to have the ability to seek allocations of capacity in accordance with the criteria provided under paragraph 7. This is confirmed by the guidance provided in relation to paragraph 7 in the Explanatory Statement to the Minister's Policy Statement:

> "The primary consideration is to introduce competition on the route in a commercially sustainable manner."[2]

An application of the relevant paragraphs of the Minister's Policy Statement demonstrates that the Italy route remains in the start up phase. Although Determination [2001] IASC 109 allocated Ansett International Limited (Ansett) 75 seats of third country code share capacity to support code share services on the three weekly flights Singapore Airlines operated on

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[2] Explanatory Statement, International Air Services Policy Statement No. 5 (Cth), 4.

the route (at a time when Qantas was operating services with its own aircraft to Italy), it cannot be said that the making of this determination represented an acquittal of the start up phase for the route. Virgin Australia notes that the definitions of "start up phase", "new entrant" and "commercially sustainable level of capacity" provided in paragraph 2 of the Minister's Policy Statement are identical to those provided under the *International Air Services Policy Statement No. 3* (Cth) which was the policy statement in effect when Determination [2001] IASC 109 was made.

At the time Determination [2001] IASC 109 was made, matters of commercial sustainability, as provided under paragraph 7 of the Minister's Policy Statement, had far less relevance to joint services provided under free sale code share arrangements. While code share services were utilised by many carriers at this time to increase the scope of their networks, own aircraft operations remained the central component of airlines' business models. Certainly in the Australian context, code share operations were of secondary importance to own aircraft operations, as code sharing was employed to augment own aircraft services and did not represent a core element of an airline's strategy. Accordingly, the profitability of Australian airlines' international operations at that time was far less dependent on the existence of efficient and commercially sustainable code share services. It is unlikely that the costs associated with free sale code share services offered by Australian carriers in the early 2000's were of a sufficient magnitude such that a minimum capacity allocation would have been required to support a commercially sustainable code share operation. Given their supplementary nature, it is logical that the investment and expenditure associated with the establishment, maintenance and promotion of free sale code share services would have been negligible. As such, the start up phase was not applicable to free sale code share services at that time and therefore the allocation of 75 seats of third country code share capacity to Ansett under Determination [2001] IASC 109 to support free sale code share services on flights operated by Singapore Airlines had no bearing on the acquittal of the start up phase.

Notably, in contrast to the current Minister's Policy Statement which came into effect in May 2004, the previous Minister's Policy Statement (No. 3 of April 1997) does not contain any references to "code share operations", which supports Virgin Australia's view that in 2001, there was no nexus between code share services, "commercially sustainable operations"[3] and the start up phase provisions. It is also relevant to note that, while the Explanatory Statement to both the current Minister's Policy Statement and the previous Minister's Policy Statement provide that, "[a]lthough the competition criteria are weighted towards use of own aircraft to operate capacity, in the long term this should not preclude new entrants from using code share or other joint services arrangements as a method of entering markets", this statement is made in reference to the paragraph 5 criteria in the previous Minister's Policy Statement and therefore has no application to the paragraph 7 criteria.

Regardless of whether it is accepted that allocations of capacity made in 2001 to support the introduction of free sale code share arrangements are relevant to the acquittal of the start up phase on a particular route, Virgin Australia submits that an assessment of whether an allocation of capacity is of a level necessary to permit the development of efficient and commercially sustainable operations on a route – whether own-aircraft or code share operations – can only be properly undertaken *after* services utilising the capacity have been

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[3] *International Air Services Policy Statement No. 5* (Cth), paragraphs 2 and 7.

implemented and operated for a period of time. The commercial sustainability of a service on any route will be affected by a number of factors, such as the reaction of competitors, prices of inputs and general economic conditions affecting demand. While it may be possible to forecast the impact that some factors would have on the commercial sustainability of a service before implementation, the responses of competitors cannot be judged as readily in this manner. Competition is dynamic, and usually unpredictable, and is often the single most significant factor affecting the commercial sustainability of air transport services, both own-operated and code share. In addition, unforeseen economic and geopolitical events can have a significant impact on consumer demand, which may not affect airlines equally. Accordingly, making an accurate assessment of whether a particular allocation is commercially sustainable or otherwise in advance of the implementation of services utilising the allocation is simply not possible. Given the stated object of the Act is to promote "...economic efficiency through competition in the provision of international air services"[4], clear and unequivocal evidence is required in order to hold that the start up phase has been acquitted in relation to any route, as acquittal has the potential to make it more difficult for carriers to enter markets, limiting competition.

Determination [2001] IASC 109 is somewhat unique in that Ansett was unable to utilise the capacity allocated to it to implement the proposed code share services as a result of being placed into voluntary administration in September 2001. Accordingly, it is only possible to speculate as to whether an allocation of 75 seats was the minimum capacity required to permit the development of efficient and commercially sustainable operations on the route. Had Ansett implemented the proposed code share services, it is reasonably foreseeable that Qantas' reaction as a competitor on the route would have had a significant impact on whether 75 seats was in fact capable of supporting efficient and commercially sustainable code share operations. In addition, the impact of the downturn in air travel following the terrorist attacks of September 11, 2001 would likely have had an effect on consumer demand for these services. Certainly, no firm conclusions can be drawn in this regard and as a consequence, it cannot be held that Determination [2001] IASC 109 represents an acquittal of the start up phase for the Italy route. In determining whether or not the start up phase has been acquitted in relation to any route, Virgin Australia expects that the Commission will reach a decision which best promotes paragraph 7's central consideration of facilitating the introduction of competition on a route in a commercially sustainable manner, as well as the Act's object as referred to above.

Based on the foregoing, it is clear that the Italy route remains in the start up phase and accordingly, Virgin Australia's application for capacity, as a new entrant, should be assessed in accordance with paragraph 7 of the Minister's Policy Statement.

Claims against the paragraph 7 criteria of the Minister's Policy Statement

As the Italy route remains in the start up phase, the pre-eminent consideration for the Commission is to introduce competition on the route through the allocation to Virgin Australia, as an initial new entrant, of sufficient capacity to develop an efficient and commercially sustainable operation, provided that each of the criteria in paragraph 7.1(a) to (d) are satisfied. These criteria are weighted in favour of allocations to new entrants.

[4] *International Air Services Commission Act 1992* (Cth), s 3.

Notwithstanding the assertions above that the start up phase provisions were not applicable to free sale code share arrangements in 2001, following the implementation of a revised policy statement in 2004 and a fundamental shift in the strategic focus of Australian airlines in recent years, it is clear that the start up phase provisions are today directly applicable to free sale code share services.

The current Minister's Policy Statement came into effect in May 2004, replacing the previous Minister's Policy Statement, which entered into effect in April 1997. As outlined in the previous section, two references to "code share operations" (paragraphs 3.3 and 3.6) were inserted into the general provisions of the current Minister's Policy Statement. The addition of these words demonstrates that code share services are encompassed within the term "commercially sustainable operations"[5], and confirmed the applicability of the start up phase provisions to code share services from the date the current Minister's Policy Statement was promulgated.

Paragraph 3 of the Minister's Policy Statement contains general guidance to assist the Commission in its consideration of applications for allocations of capacity. The Commission should have regard to the guidance provided in this paragraph in its assessment of all applications, including those made under the start up phase provisions. To aid the Commission's interpretation of paragraph 3, the Explanatory Statement accompanying the current Minister's Policy Statement provides that, "[a]lthough the competition criteria are weighted towards the use of own aircraft to operate capacity, in the long term this should not preclude new entrants from using code share or other joint services arrangements as a method of entering markets".[6] Relevantly, as highlighted in the previous section, these words were also included in the Explanatory Statement which accompanied the previous Minister's Policy Statement, but in reference to paragraph 5, not paragraph 3. Accordingly, these words only became relevant to the interpretation of the general paragraph 3, and therefore paragraph 7, when the current Minister's Policy Statement came into effect. Given that the aim of paragraph 7 is to facilitate the introduction of services by new entrants, the guidance provided in the Explanatory Statement provides clear evidence that Australian carriers may now rely on the start up phase criteria to seek allocations of code share capacity in order to gain access to markets as new entrants.

The global aviation landscape has undergone immense change since 2001. One of the most significant changes involves the increased reliance airlines have placed on cooperative marketing arrangements and strategic alliances (some involving equity stakes and mergers) in order to increase revenues by providing their passengers with access to markets for which own aircraft operations would be not viable. These partnerships, and associated code share services, are no longer merely supplementary to an airline's business model as they were a decade or so ago. Rather, these partnerships are now central to the strategy of many airlines. This is certainly the case for those carriers designated in countries with relatively small markets and whose geographic position provides very limited hub opportunities, such as Australia.

The growth in airlines seeking to expand their international networks via code share services and the relevance of such services to airlines' competitiveness was acknowledged by the Department of Infrastructure and Transport in relation to the Australian Government's

[5] *International Air Services Policy Statement No. 5* (Cth), paragraphs 2 and 7.
[6] Explanatory Statement, International Air Services Policy Statement No. 5 (Cth), 4.

aviation policy settings in its letter to the Australian Competition and Consumer Commission regarding Virgin Australia and Singapore Airlines' 2011 application for authorisation of its alliance:

> "As you would be aware, it has been a recognised trend within the aviation industry for airlines to enter into co-operative arrangements. Major airlines around the world have joined one of the three major alliances: Oneworld, Star Alliance and Sky Team. Taken together, the three dominate world air traffic.
>
> There has also been a growth in airlines focusing on the virtual expansion of their international networks. The most recent Australian example is the approach taken by Virgin Australia in pursuing its 'virtual international network' via partnerships with Etihad Airways and Delta Air Lines, and the proposed arrangement with Singapore Airlines, in order to compete more effectively with the integrated network offered by other international airlines (including Qantas)."[7]

Evidence of the increasing importance of code share services between 2001 and 2012 in the Australian context is also found in a comparison of the number of countries Qantas served with own aircraft operations and code share operations in those years.

Countries served by Qantas* own-aircraft and code share services	Own-aircraft	Code share
Northern Summer 2001 timetable summary[8]	21	26
Northern Summer 2012 timetable summary[9]	18	37

*including countries served by Jetstar Airways

The table above reveals that between 2001 and 2012, the number of countries served by Qantas with its own aircraft contracted slightly, while the number served through code share operations expanded substantially. During this period, Qantas chose to enter new markets, or replace some of its own aircraft operations, with code share operations.

While airlines' network decisions are influenced by a range of factors, both internal and external, the comparison above confirms that accessing markets via code share services has become very important. It is therefore essential that on routes where capacity for code share operations is limited, airlines hold the minimum allocation of capacity necessary to ensure that such services are commercially sustainable, given the significant role that code sharing now occupies in airlines' networks and strategic objectives.

An efficient and commercially sustainable code share operation requires that revenue earned is sufficient to offset the associated investment and expense over an extended period of time. For airlines whose strategic objectives are underpinned by the establishment of integrated alliances, the costs associated with the introduction, maintenance and

[7] Letter from Department of Infrastructure and Transport to the Australian Competition and Consumer Commission, 5 September 2011, 2.

[8] Department of Infrastructure and Transport International Airlines Timetable Summary <http://www.infrastructure.gov.au/aviation/international/timetable.aspx>.

[9] Department of Infrastructure and Transport International Airlines Timetable Summary <http://www.infrastructure.gov.au/aviation/international/timetable.aspx>.

promotion of an extensive network of code share operations are significant and include the following:

- costs related to the negotiation and settlement of code share and special prorate agreements;
- code share implementation testing costs;
- costs associated with modifications to information technology infrastructure;
- reservations platform vendors' fees for testing and production;
- global distribution system and other distribution platform costs;
- fees charged by schedule and fare distribution agents for flight number allocation and exchange;
- costs associated with securing regulatory approvals; and
- sales, marketing and promotional costs.

Most of these costs would be incurred by Virgin Australia in connection with free sale code share operations on the Italy route. Notably, the sales costs would include the expense associated with a dedicated Virgin Australia sales presence in Italy.

With block space code share arrangements[10], the costs of the block itself, as well as the required revenue management resources, are additional costs that require recovery. Compared with free sale code share services, the scale of costs associated with sales, marketing and promotional activities may also be greater in respect of those routes for which a block space arrangement is in place, as a marketing airline will seek to mitigate the commercial risk of failing to sell all seats within its block space allocation.

The costs noted above will increase as the scope and complexity of an airline's code share operations increase. Airlines with extensive code share networks must manage these costs carefully to ensure that they are offset by revenues derived through code share operations.

One of the key factors impacting the commercial sustainability of code share operations on a route is whether an airline has the ability to attain a critical mass by selling a sufficient number of code share seats to recover its costs. On routes where code share capacity is limited under the relevant bilateral, the commercial sustainability of code share services will depend on whether an airline is able to secure an allocation of an amount of capacity sufficient to facilitate the development of efficient and commercially sustainable operations on a route. If an airline does not have sufficient code share inventory to sell, it will not be able to recover its costs in a sustainable manner.

While Virgin Australia is confident that the material presented above confirms that the start up phase provisions now apply to free sale code share services, it is certainly beyond doubt that code share operations which incorporate a block space arrangement are encompassed by the start up provisions. Virgin Australia undertakes to implement a block space arrangement as part of its code share operations on the route in order to secure the capacity requested under the start up phase provisions.

[10] Under block space code share arrangements, a specified number of passenger seats are purchased by an airline for the carriage of its traffic on an aircraft of a second carrier (International Civil Aviation Organization, *Manual on the Regulation of International Air Transport* (3rd ed, 2004), 4.1-7).

Although it may not have been the case in 2001 that a commercially sustainable operation encompassed free sale code share operations, and therefore the paragraph 7 criteria were not applicable to allocations of code share capacity at that time, given that code share services are now a primary means of entering new markets for Australia's international airlines and central to their long term strategies, it is imperative that the start up provisions can be relied on in order to secure the minimum allocation of capacity necessary to support the development of efficient and commercially sustainable code share operations on a particular route. To hold otherwise would impede the Act's object of enhancing "...the welfare of Australians by promoting economic efficiency through competition in the provision of international air services".[11]

Virgin Australia has addressed each of the four criteria in paragraph 7 below, in support of the presumption that the Commission should allocate Virgin Australia the 300 seats per week of third country code share capacity it has sought on the Italy route as a new entrant.

7.1 (a) the level of capacity available and in prospect is sufficient to support efficient, commercially sustainable operations by both a new entrant and an incumbent Australian carrier

There are 600 seats per week of code share capacity allocated under Determination [2007] IASC 113. An allocation of 300 seats per week to Virgin Australia would support efficient and commercially sustainable code share operations by both Virgin Australia and Qantas on the Italy route. The application for 300 seats is based on the level of interline traffic Virgin Australia currently sells on the route combined with the expectation (based on experience in other markets) that traffic numbers will grow significantly following conversion to code share services. Increased sales follow conversion as code share services occupy a better display position in computer reservation systems in cases where flights are treated as online services with a higher priority in listing than interline services[12], increasing the likelihood that such services will be selected for sale by a travel agent.

The Australia-Italy market expanded by almost 20 per cent between 2009/10 and 2011/12[13]. The increasing number of passengers on the route will not only support the development of Virgin Australia's code share operations as a new entrant, but will also underpin the continued commercial sustainability of Qantas' code share operations as the incumbent. It is critical to note that if 300 seats per week are allocated to Virgin Australia, Qantas will still hold a total of 700 seats per week to support code share operations on the route (Qantas holds an additional 400 seats per week under Determination [2010] IASC 104). It is reasonable to expect that 700 seats per week of code share capacity will be adequate to support commercially sustainable code share operations by Qantas.

From both a supply and demand perspective, it can therefore be concluded that the 1,000 seats per week of third country code share capacity available to Australian carriers under the Australia-Italy bilateral is capable of supporting efficient, commercially sustainable operations by both Virgin Australia, as a new entrant, and Qantas, as the incumbent, on the Italy route.

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[11] *International Air Services Commission Act 1992* (Cth), s 3.

[12] International Civil Aviation Organization, *Manual on the Regulation of International Air Transport* (3rd ed, 2004), 4.8-3.

[13] Department of Immigration and Citizenship – Origin and Destination movements FY10 to FY12.

7.1 (b) the new entrant's tariff and service proposals would enhance competition on the route

Virgin Australia intends to code share on Singapore Airlines' one-stop five weekly services to Milan and its three weekly services to Rome, as well as Etihad's one-stop daily services to Milan (Northern Winter 2012-13 schedule). Virgin Australia's three times weekly own aircraft operations between Sydney and Abu Dhabi will also connect with Etihad's services to Milan.

The code share operations proposed by Virgin Australia will provide direct competition to the extensive code share services that Qantas offers on the route on Cathay Pacific's one-stop daily flights to both Milan and Rome, and British Airways' two-stop (via Singapore and London) 20 weekly services to Milan and 30 weekly services to Rome (Northern Winter 2012-13 schedule). Virgin Australia's code share operations will also compete with foreign carriers serving the route, such as Emirates, Cathay Pacific and Malaysia Airlines.

The introduction of code share operations by Virgin Australia would enhance competition on the Italy route by opening an additional distribution channel for both Singapore Airlines and Etihad, stimulating growth in the market, contributing to the performance of such services and ultimately leading to lower average airfares. Qantas, Cathay Pacific, British Airways and other foreign carriers serving the route will seek to defend their market share, leading to enhanced competition.

Average airfares on the Italy route have increased in recent years[14], which is likely to have contributed to the four per cent decline in inbound leisure travellers between 2009/10 and 2011/12[15], particularly given the subdued economic conditions in Europe and exchange rate movements. The increased competition that Virgin Australia's proposed code share operations will bring could be expected to stimulate growth in the price-sensitive leisure segment of the market. Although Virgin Australia has been granted authorisation by the relevant competition regulators to engage in joint pricing with both Singapore Airlines and Etihad from specified points of sale, implementation of a block space code share arrangement will introduce a further element of price competition on the route. In order to sell its block allocation, Virgin Australia will need to ensure its pricing is competitive in relation to Singapore Airlines, Etihad and other foreign carriers, with consequential benefits for consumers.

The connections between Australia and Italy offered by Singapore Airlines, Etihad and Virgin Australia (Virgin Australia's own aircraft operations to Abu Dhabi which connect with Etihad's Milan services) at their respective intermediate points are more efficient than those offered by Cathay Pacific, British Airways and Qantas (Qantas' own aircraft operations which connect with Cathay Pacific's and British Airways' services). As a result, Virgin Australia's proposed code share operations involve significantly shorter total travel times and will therefore represent an attractive proposition for travellers on the route, particularly the time-sensitive business traveller.

Additionally, passengers travelling on a Virgin Australia code share service will have the flexibility to include a stopover on their way to/from Italy at Singapore, as the one point that has been nominated under the Australia-Italy air services arrangements at which marketing carriers may exercise own stopover rights in the territory of a third country. Notwithstanding

[14] Tourism Australia, Italy market profile, June 2012, 8.

[15] Department of Immigration and Citizenship – Origin and Destination movements FY10 to FY12.

that the Australia-Italy air services arrangements only permit stopovers at one point for third country code share arrangements, the Australia-Hong Kong air services arrangements do not permit marketing carriers to exercise own stopover rights in Hong Kong, preventing passengers travelling on a Qantas code share service operated by Cathay Pacific from including a stopover in their trip to Italy. Similarly, passengers travelling to Italy on a two-stop Qantas code share service operated in conjunction with British Airways cannot include a stopover at London in their trip, due to limitations in the Australia-Italy air services arrangements. Virgin Australia's ability to offer its passengers a one-stop service which includes a stopover in Singapore will provide flexibility in passengers' itineraries, enabling them to break their journey for business or leisure reasons.

As outlined above, Virgin Australia's tariff and service proposals will result in increased competition on the route. An allocation of 300 seats per week on the Italy route will enable Virgin Australia to strengthen its competitive position against Qantas, and will therefore contribute to the development of a vibrant and sustainable Australian international aviation industry.

7.1 (c) approval would not result in a decrease in inbound tourism to Australia or to Australian consumer benefits or trade

Approval of Virgin Australia's application would not result in a decrease in inbound tourism to Australia or to Australian consumer benefits or trade. On the contrary, approval will enable Virgin Australia to introduce code share operations on the Italy route which have the potential to increase inbound tourism and deliver enhanced benefits to Australian consumers. Trade would not be impacted, as Virgin Australia's proposed code share operations do not encompass any arrangements regarding freight.

As outlined above, the implementation of code share operations by Virgin Australia will enhance competition on the route, creating the potential for lower airfares. This could be expected to increase the number of inbound visitors to Australia. In May 2012, Virgin Australia signed a $6m cooperative marketing memorandum of understanding with Tourism Australia aimed at using our alliance network to boost visitation from a number of key markets including continental Europe, and would look to leverage funds committed to attract visitors from Italy, to complement and support Virgin Australia's dedicated sales presence in Italy.

Virgin Australia's proposed code share services will support Australia's tourism industry, not just in Australia's major gateways, but also in regional areas, as passengers travelling on a Virgin Australia code share service from Italy will have direct access to its extensive domestic network.

A more competitive market structure may also lead airlines to undertake more innovative sales and marketing activities, both inbound and outbound, with consequential benefits for Australian consumers and Australia's tourism sector.

As Australian residents comprise approximately 70 per cent of traffic on the Australia-Italy route[16], the potential benefits to consumers are considerable. Australian residents travelling

[16] Department of Immigration and Citizenship – Origin and Destination movements FY12.

to Italy for holidays grew by 40 per cent between 2009/10 and 2011/12[17]. There is also a strong component of Australian residents who travel on the route to visit friends and relatives, with Italy representing the second most common country of ancestry nominated by Australians in the 2011 census after the UK/Ireland[18].

In addition to the benefits that Australian consumers will enjoy from the enhanced competition which will follow the introduction of Virgin Australia's code share operations to Italy, especially competitive fares, passengers will have the ability to undertake a seamless journey on Virgin Australia's code from anywhere in Virgin Australia's network and will be able to earn Velocity Frequent Flyer points for their entire journey. As noted above, consumers will also enjoy the convenience of more one-stop services, efficient connections and shorter travel times, as well as the ability to include a stopover in their trip at Singapore.

Accordingly, implementation of Virgin Australia's proposed code share services will be positive for both Australia's inbound tourism sector and Australian consumers.

7.1 (d) the new entrant is reasonably capable of obtaining the necessary approvals and commencing operations as proposed

Virgin Australia has substantial experience in securing the necessary economic approvals to support the introduction of code share operations in new markets. To date, Virgin Australia has successfully obtained approvals from each of the relevant aeronautical authorities to support the implementation of code share operations to 32 countries.

Should Virgin Australia be successful in its application, immediate steps will be taken to secure the requisite approvals from the Australian Department of Infrastructure and Transport, the Abu Dhabi Department of Transport, the Civil Aviation Authority of Singapore and the National Civil Aviation Administration of Italy. In coordination with Singapore Airlines and Etihad, Virgin Australia will aim to commence code share operations as soon as practicable after these approvals have been obtained.

Virgin Australia, as a new entrant on the Italy route, is therefore reasonably capable of implementing its proposal by obtaining the necessary approvals and commencing code share operations.

[17] Department of Immigration and Citizenship – Origin and Destination movements FY10 to FY12.

[18] Australian Bureau of Statistics, *Cultural Diversity in Australia – Reflecting a Nation: Stories from the 2011 Census* < http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/2071.0main+features902012-2013>.