AUSTRALIAN COMPETITION & CONSUMER COMMISSION

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Jasmina Ackar
Director
International Air Services Commission (IASC)
CANBERRA ACT 2601

By email: jasmina.ackar@infrastructure.gov.au

Dear Jasmina

Re: Qantas application for variations to Determinations – Indonesia route

Thank you for inviting the ACCC to comment on the application from Qantas Airways Limited (**Qantas**) to vary a number of Determinations to permit PT Garuda Indonesia (Persero) Tbk (**Garuda Indonesia**) to offer code share services on flights operated by Qantas between Australia and Indonesia.

In general terms, where cooperative arrangements between airlines contain provisions with the purpose or likely effect of fixing, controlling or maintaining prices, or the purpose of restricting output or allocating territories, suppliers or customers, or where they would otherwise have the purpose or likely effect of substantially lessening competition, those arrangements may be illegal without prior authorisation under the Competition and Consumer Act 2010 (the Act). Not all code share arrangements contain provisions of this kind, and the ACCC notes that no application for authorisation under the Act has been received from Qantas and Garuda Indonesia in relation to any form of cooperative arrangement, including the proposed code share arrangement.

However, the ACCC has considered a number of applications for authorisation of arrangements between airlines under the Act. Broadly speaking, the Act requires the ACCC to assess the public benefits and public detriments (including anti-competitive effects) of each arrangement in determining whether to grant authorisation. We draw on this experience to highlight some issues that the IASC may wish to consider when assessing Qantas' codeshare application. The ACCC recognises that the IASC takes into account different factors in its role of assessing the benefit to the public in making a decision to vary an allocation of capacity.

The ACCC notes in providing this submission that it has not had:

- recent need to examine the competitive environment on the Indonesia route in considering applications for authorisation of arrangements between airlines
- access to information relevant to evaluate the likely public benefits and competition effects of the proposed code share arrangement, including proposed codeshare

terms between the parties, passenger numbers and number of seats flown on each city pair on the Indonesia route, and average load factors, fares and profit achieved by each airline on individual city pairs for a representative time period.

The application for variation

The ACCC understands that the IASC received an application from Qantas to permit Garuda Indonesia to code share on Qantas services operated between Australia and Indonesia on a free sale basis. That is, Garuda Indonesia proposes to add its code to all Qantas operated services on the Indonesia route including from Sydney and Melbourne to Jakarta and Denpasar (Bali). The arrangement does not include Jetstar services.

The ACCC understands this is a traditional arms-length free sale codeshare agreement where the marketing carrier (initially only Garuda Indonesia) and the operating carrier (initially only Qantas) independently determine the fares for the services operated by the operating carrier. The marketing carrier pays the operating carrier an agreed amount for each seat booked, so the potential for price competition in a codeshare arrangement is typically limited to the margin each carrier applies on top of the seat cost when selling fares.

A free sale code share agreement allows the marketing carrier to sell an unlimited number of seats on the operating carrier's service provided that there is inventory available on the flight. This means there is limited incentive to compete on price in the marketing of the operating carrier's inventory because the marketing carrier only pays for the seats it sells.

The ACCC's views on free sale versus hard block codeshare arrangements were set out in detail in its submission to the IASC on the application for variation lodged by Qantas in relation to the Papua New Guinea route in 2016.[1]

The ACCC remains of the view that, from a competition perspective, a hard block codeshare generally is preferable to a free sale codeshare since it maintains a greater degree of rivalry between the airlines in the marketing of the operating carriers' services. Both are inferior to 'metal' competition between operating carriers, where this is commercially viable.

The ACCC understands that Qantas does not intend to place its code on Garuda Indonesia services on the Indonesia route during the initial phase of the codeshare agreement, but the application before the IASC is for a reciprocal codeshare arrangement. As long as there is a prospect that the arrangement could be implemented on a reciprocal basis during the term of the IASC's decision, we suggest it is appropriate for the IASC to consider the public benefits and competition effects of a reciprocated codeshare arrangement.

Current services between Australia and Indonesia

According to Qantas' submission,[2] Jetstar operated the largest number of seats between Australia and Indonesia during the year ending April 2023 with 50% of seats flown on the Indonesia route. The Qantas Group combined— comprising both Jetstar and Qantas— operated 62% of seats on the route and Garuda Indonesia operated 4% of seats. Virgin Australia operated 14% of seats during this time.

The IASC needs to consider whether the 12 months ending April 2023 provides a relevant baseline for its assessment. The data range selected by Qantas shows Garuda Indonesia in

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

[2] See Qantas submission addressing the additional public benefit criteria (Section 9 of the Minister's Policy Statement 2018) in support of its application here (3 November 2023).

a very different position to the one it held prior to the COVID-19 pandemic and the one it holds currently. On current information, Garuda Indonesia is operating 15 services per week (each way) between Australia and Indonesia, compared to Qantas' 19 services.

Qantas currently operates the following services on the Indonesia route:

- 4 services per week (each way) between Sydney and Denpasar (Bali)
- 5 services per week (each way) between Melbourne and Denpasar (Bali)
- 7 services per week (each way) between Sydney and Jakarta
- 3 services per week (each way) between Melbourne and Jakarta

Garuda Indonesia currently operates the following services on the Indonesia route:

- 4 services per week (each way) between Sydney and Denpasar (Bali)
- 4 services per week (each way) between Melbourne and Denpasar (Bali)
- 4 services per week (each way) between Sydney and Jakarta
- 3 services per week (each way) between Melbourne and Jakarta.

The ACCC notes that capacity on the Indonesia route is currently constrained on the Australia side, with the IASC currently assessing competing applications from Qantas and Virgin Australia for the last remaining (unallocated) capacity on the route.

Assessment

The below information sets out a number of issues and factors that the IASC may wish to take into consideration in its assessment of whether the proposed code share arrangements between Qantas and Garuda Indonesia is likely to be in the public interest.

Relevant markets

The ACCC considers the proposed code share arrangement between Qantas and Garuda Indonesia has the potential to impact competition in the following markets:

- Australia – Indonesia international air passenger services market – this market includes direct flights between Australian international gateways and Indonesia. Passengers who travel on these flights may be travelling as part of a journey that originates or ends at an airport in Australia that is not an international gateway or at an airport in Asia that is not in Jakarta or Denpasar (Bali).
- Australian domestic air passenger services market – this market encompasses all regular scheduled passenger flights within Australia, including those taken by passengers connecting to/from an international flight.

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

Likely future with and without

It will be important for the IASC to compare the likely future with and without the proposed code share arrangement in place, in its assessment of competition or any other benefits.

The ACCC applies a 'future with-and-without test' to identify and weigh the public benefit and public detriment generated by an arrangement for which authorisation is sought. Under this test, the ACCC compares the public benefit and anti-competitive detriment generated by an arrangement in the future with that conduct, with those generated in a future without that conduct. This requires the ACCC to predict how the relevant markets will react if that arrangement does not occur.

For the assessment that the IASC is undertaking, the ACCC considers that the likely ‘future without’ could involve no airline entering into a codeshare arrangement or other type of cooperative arrangement with any other carrier operating on the Indonesia route, except where it is a legally related entity (e.g. Qantas and Jetstar):

- Qantas Group utilising the capacity allocated to it by the IASC.
- Garuda Indonesia would be likely to continue reinstating pre-COVID levels of service where it is profitable to do so. It may also add additional services (up to the limit of its available capacity under Australia’s Air Services Agreement with Indonesia) where it becomes profitable to do so.
- Qantas and Garuda Indonesia would compete on the basis of price and their service offerings as full-service carriers.
- Virgin Australia utilising the capacity allocated to it by the IASC, including if allocated additional capacity by the IASC, on routes between Australia and Denpasar (Bali). Under its current business model, Virgin Australia is not likely to commence services between Australia and Jakarta.

Public benefits

In its assessment of applications for authorisation of joint service agreements and alliances arrangements between airlines, the ACCC typically considers the following potential categories of public benefits:

- new and enhanced products and services through coordination of schedules and connection options, reciprocal lounge access, and reciprocal access to each others’ frequent flyer programs.
- cost savings and other efficiencies through joint or coordinated operations
- increased tourism in Australia (only if the conduct is likely to stimulate additional passenger traffic to Australia)
- increased competition (only if the conduct is considered likely to trigger a pro-competitive response from rival airlines operating in the same market(s)).

The ACCC notes that the degree of coordination between airlines required to give rise to material public benefits under any of these categories is usually beyond the scope of a traditional arms length codeshare arrangement.

For itineraries that require the use of both Qantas and Garuda operated services (complementary journeys), code sharing can confer public benefits by allowing a more seamless customer experience for passengers who:

- prefer to book through Garuda Indonesia to fly to locations in Australia served by Qantas but not Garuda Indonesia; and
- prefer to book through Qantas to fly to locations in Indonesia served by Garuda but not Qantas.

Codeshare arrangements can also have a positive impact on marketing competition on thin routes between Australia and Indonesia where passenger demand is only sufficient to support flights by a single operator. It can facilitate new entry or the earlier commencement of additional frequencies by reducing the business risks of capacity additions in circumstances where they otherwise may not be profitable.

However, on city pairs where underlying passenger demand is sufficient for 2 carriers to operate profitably – having regard to average load factors, fares and margins achieved - the concern is that, rather than facilitating marketing competition, the codeshare arrangement may delay or displace much more meaningful 'metal' competition between Qantas and Garuda Indonesia. This is discussed further below.

Effect on competition

In assessing applications for authorisation, the ACCC considers the extent to which arrangements between competitors may result in any public detriment, in particular, if the arrangements would result or would be likely to result in a lessening of competition in the relevant market(s), having regard to individual city pairs.

In previous authorisation matters involving arrangements between competing airlines, the ACCC has identified anti-competitive detriments on city pairs where the participating carriers do not face sufficient competitive constraint from rivals to make it unprofitable to profitably raise fares (including by delaying capacity additions) and/or reducing service quality as a result of the conduct.[3]

While it is a matter for the IASC, a key competition concern is that Qantas and Garuda are each other's closest competitor in the Australia – Indonesia air passenger services market and the proposed codeshare arrangement may soften competition between them. It may make it mutually profitable for Garuda Indonesia and/or Qantas to delay or limit the addition of capacity on city pairs where the underlying market conditions support profitable metal competition. This could result in higher fares and reduced competitive pressure to improve service levels, compared to the future without the codeshare.

It is not clear that Virgin Australia would provide a sufficient competitive constraint to make such behaviour unprofitable for Qantas and Garuda Indonesia. Virgin Australia's ability and incentive to constrain any increase in airfares by Qantas and/or Garuda Indonesia is substantially limited by its inability to add capacity beyond its IASC allocation and its business focus on Australia-Denpasar routes only. The ACCC understands Qantas and Garuda Indonesia are the only airlines that currently operate services from Sydney and Melbourne to Jakarta and this situation is likely to continue for some time.

Role of the ACCC

The ACCC notes that any decision by the IASC to approve the code sharing arrangements between Qantas and Garuda Indonesia does not provide any protection for the airlines under the Act and does not prejudice any possible future consideration of codeshare arrangements by the ACCC.

I hope that this letter assists you in your consideration of the application from Qantas. If you wish to discuss any aspect of this letter further, please do not hesitate to call Tony Hilton on 08 9325 0620.

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[3] See ACCC's decision in relation to Qantas and Emirates application for authorisation to coordinate operations across their global networks here. In assessing this application, the ACCC was concerned that the coordination may impact competition on the Sydney to Christchurch route, because Air New Zealand was the only other airline operating on that route. The ACCC granted authorisation with a condition requiring Qantas and Emirates to provide regular updates to the ACCC on passenger revenue and operating costs to monitor competition on this route over the 5 period of authorisation.

Yours sincerely

Lyn Camilleri
General Manager
Competition Exemptions