

DECISION

DECISION: [2000] IASC 203
VARIATION OF: IASC/DET/9804 AND IASC/DET/9910
THE ROUTE: JAPAN
THE APPLICANT: QANTAS AIRWAYS LIMITED
(QANTAS) (ACN 009 661 991)

1 The application

1.1 On 30 December 1999, Qantas applied to the Commission to vary Determinations IASC/DET/9804 and IASC/DET/9910 (the Determinations) allocating capacity on the Japan route to allow Qantas to continue code sharing on Japan Airlines' services on the Osaka route until 30 June 2003. Subsequently on 17 February 2000 Qantas wrote to the Commission indicating that it was prepared to amend its application to shorten the period to 31 March 2001.

1.2 Qantas currently code shares on Japan Airlines services on the Osaka route under arrangements which are approved until 31 March 2000.

1.3 The Commission published a notice inviting submissions from interested parties about the Qantas application. A submission was received from Tropic Isle Retail Stores (Tropic Isle).

1.4 All non-confidential material supplied by the applicant is filed on the Register of Public Documents. Any confidential material supplied by the applicant is filed on the Commission's confidential register.

2 Provisions of relevant air services arrangements

2.1 The Memorandum of Understanding of 9 December 1992 (1992 MOU) and the Australia - Japan Air Services Agreement of 19 January 1956 provide for the multiple designation of Australian carriers. The 1992 MOU also enables the designated airlines of both countries to operate joint passenger, freight and/or mixed services between Japan and Australia subject to the conclusion of a commercial agreement or agreements between the designated airlines of the two countries which have been approved by the respective aeronautical authorities.

2.2 A further Memorandum of Understanding of 20 December 1996 (1996 MOU) restricts the portion of the total capacity entitlement that may be used by each country between Australia and Kansai airport at Osaka to 21.2 B767-200 units and 14 frequencies per week. Qantas is using 7.0 units/7 frequencies through code sharing on JAL B747 services. JAL also utilises 7.0 units/7 frequencies. All Nippon (ANA) is using 7.0 units/7 frequencies code sharing on Ansett International's B747 services. Ansett International utilises 7.0 units/7 frequencies.

2.3 As all Australia's frequency entitlements are currently being used, there is no capacity available for additional services.

3 Applicant's proposals and claims

3.1 Qantas states that it has re-evaluated the possibility of resuming its own services to Osaka, but sees no prospect of doing so on a profitable basis at current demand and capacity levels. Qantas submitted confidential data to support this statement.

3.2 Qantas has forecast only a small increase in traffic on the Japan route in the year 2000 after declines in 1998 and 1999. Furthermore, Qantas believes there is little evidence to support a significant change in overall demand on the Osaka route. However, Qantas expects an increase in carriage of about 5-10 percent following the implementation of a marketing plan that will involve a greater selling effort for the Osaka flights.

3.3 Qantas claims a number of public benefits from remaining on the route:

- its ability to participate in and to continue to develop the Osaka market;
- withdrawal would mean a less competitive market;
- withdrawal would lead to reduced expenditure on promotion of Australia in the Osaka market;
- its ability to quickly and easily re-enter the Osaka market in its own right as conditions improve; and
- its ability to continue to offer daily services while operating in the most efficient and financially sound manner.

3.4 Qantas states that the alternative to continuing to code share on JAL's service is to withdraw from the route entirely. Qantas also states that it will continue to evaluate, on a regular basis, the resumption of Qantas operated flights.

4 Tropic Isle submissions

4.1 In its submissions Tropic Isle makes the following points:

- Qantas should either start own operations or hand back capacity;
- Qantas is not actively promoting its services in the Osaka region (a survey of passengers at Hamilton Island showed that while 32 per cent are from Kansai, only two per cent travelled as Qantas passengers);
- Tropic Isle is a potential applicant for capacity on the route and the IASC must take this into account;
- the IASC should consider inviting other applicants rather than approving code share operations automatically;
- in 1993 the IASC concluded that Tropic Isle was reasonably capable of obtaining the necessary approvals to operate on the route;

- it would be very difficult to operate inclusive tour charters on the Osaka route, as Qantas has suggested, as the large tour operators, who dominate the Japanese market, are only interested in negotiating with RPT operators; and
- the real reason for Qantas' unwillingness to hand back capacity on the Osaka route is that it contributes to Qantas and JAL domination of the Japan market.

5 Commission's assessment

5.1 When considering applications to vary determinations the Commission must determine whether the determination, as varied, would be of benefit to the public. Under paragraph 4 of the Minister's policy statement the use of Australian entitlements is of benefit to the public. For an established international carrier such as Qantas this means that there is public benefit arising from the use of capacity entitlements.

5.2 Traffic on the Japan route as a whole declined in 1998 and 1999. However, traffic on the Osaka route increased slightly over the same period.

5.3 Large increases in capacity in 1997 resulted in a substantial gap between supply and demand on the Osaka route. While modest growth on the Osaka route and withdrawal of services by All Nippon and Qantas has seen this gap closing, traffic from the Osaka region is predominantly tourist traffic, which tends to be low yielding. Higher passenger loads and growth do not necessarily correlate with economically sustainable operations when yields are low. The Commission has accepted in previous decisions (IASC/DEC/9801, IASC/DEC/9816 and IASC/DEC/9901) that the moves by Qantas to code share on JAL and All Nippon to code share on Ansett are, at least in part, in response to the capacity and yield situation.

5.4 There is evidence available to the Commission to indicate that no one carrier dominates the Osaka route and all carriers have a reasonable market share. If Qantas were to withdraw and JAL retained its services then JAL would be likely to become by far the single largest carrier on the route in terms of capacity and market share.

5.5 The Commission has previously examined and approved the code share arrangement between Qantas and JAL on the Osaka route. The Commission notes that the agreement is a blocked space type agreement where Qantas is obliged to pay for a certain number of seats on each flight irrespective of whether they are sold. Compared with a free sale type agreement there is a much greater financial penalty for a carrier that has not been active in the market.

5.6 Tropic Isle raised the issue of whether approving code sharing on a capacity constrained route is locking up capacity that might otherwise be used for own aircraft operations.

5.7 In its letter of 4 February Qantas stated that while Tropic Isle has suggested that it would be an applicant for capacity which may be released, it has no experience or expertise in the establishment and operation of scheduled services. Tropic Isle makes the point that it cannot demonstrate its credentials as a potential applicant for scheduled services on the Japan (Osaka) route in the absence of there being any

available capacity for which it can apply. As Qantas has pointed out, one way in which Tropic Isle could demonstrate its capability to perform international air services would be to operate inclusive tour charters. Tropic Isle has ruled this out, however, on the grounds that Japanese tour operators generally only negotiate with RPT airlines.

5.8 With regard to Tropic Isle's statement about a 1993 determination by the IASC, the Commission determined at that time that Tropic Isle was reasonably capable of obtaining the necessary approvals to operate on the route, but it was not able to conclude that Tropic Isle was reasonably capable of implementing its proposals (IASC/DET/9308).

5.9 The Commission considers that were it to reject the Qantas application there is a strong possibility that Qantas would withdraw from the route entirely and return the unused capacity. However, no other existing airline has expressed an interest and the Commission is not confident, on the basis of information available to it, that there is a realistic prospect of capacity being allocated to a prospective new airline at this time. While there would be a greater public benefit were Qantas to revert to serving Osaka in its own right, the Commission considers that for competition and tourism promotion reasons it is preferable for Qantas to continue to have a presence in the market through code sharing than to have none at all. Also, Qantas would be in a much stronger position to return to the route in its own right if it has maintained a presence in the interim.

5.10 The Commission has serious reservations, however, about the length of the extension originally requested, given the possibility that other airlines will be prevented from introducing new or additional own aircraft operations if over the next three years the Australian Government is not able to negotiate more capacity. The Commission believes that the code share should only be approved for a period of 12 months under the circumstances. Qantas has pointed out that the period originally applied for was broadly consistent with that approved for Ansett International on the route. The Commission considers, however, that the Ansett International situation is quite different in that it is the operating carrier.

5.11 Having regard to the foregoing, the Commission has decided to approve the Qantas application for an extension of the code share for a period of 12 months, effective from 1 April 2000. This will provide an opportunity for prospective applicants for this capacity to develop proposals for use of this capacity after 31 March 2001, if Qantas does not revert to own aircraft operations.

6 Decision [2000] IASC 203

6.1 In accordance with section 24 of the Act, the Commission varies Determination IASC/DET/9804 as requested by Qantas by:

permitting Qantas to operate services jointly with JAL between Australia and Japan as follows:

- 6 B767-200 units of the capacity and six frequencies per week at Kansai may be used by Qantas to provide services jointly with Japan Airlines over the period 1 April 2000 to 31 March 2001, or as otherwise approved by the Commission; and

- in accordance with the code share agreement of 20 March 1998, as amended with the prior approval of the Commission, subject to the following conditions:
 - Qantas must price and sell its services on the route independently;
 - Qantas must not share or pool revenues; and
 - Qantas must take all reasonable steps to ensure that passengers are informed at the time of booking of the carrier actually operating the flight.

6.2 In accordance with section 24 of the Act, the Commission varies Determination IASC/DET/9910 as requested by Qantas by:

permitting Qantas to operate services jointly with JAL between Australia and Japan as follows:

- 1 B767-200 unit of the capacity and one frequency per week at Kansai may be used by Qantas to provide services jointly with Japan Airlines over the period 1 April 2000 to 31 March 2001, or as otherwise approved by the Commission; and
- in accordance with the code share agreement of 20 March 1998, as amended with the prior approval of the Commission, subject to the following conditions:
 - Qantas must price and sell its services on the route independently;
 - Qantas must not share or pool revenues; and
 - Qantas must take all reasonable steps to ensure that passengers are informed at the time of booking of the carrier actually operating the flight.

Dated: 21 February 2000

Michael Lawriwsky
Member

Stephen Lonergan
Member