



INTERNATIONAL AIR SERVICES COMMISSION

DECISION

DECISION: [2001] IASC 210
VARIATION OF: IASC/DET/9804 AND IASC/DET/9910
THE ROUTE: JAPAN
THE APPLICANT: QANTAS AIRWAYS LIMITED
(ACN 009 661 901)
PUBLIC REGISTER FILES: IASC/APP/200102

1 The application

1.1 Qantas Airways Ltd (Qantas) applied to the Commission on 17 January 2001 to vary IASC Determinations IASC/DET/9804 and IASC/DET/9910 to enable Qantas to operate certain allocated capacity between Australia and Tokyo, rather than between Australia and Osaka. Seven B767-200 units of capacity in total are allocated under these determinations. Qantas has sought to be able to utilise the capacity to Tokyo when runway slots at Narita Runway B become available. It expects that it would be in a position to commence daily B767-300 flights in June 2002. Qantas has also sought the removal from the determinations of references to the operation of joint services with JAL and related conditions.

1.2 These variations have been prompted by changes in December 2000 to the Australia – Japan air services arrangements. The bilateral changes mean that capacity used by a marketing carrier in code sharing on another carrier's services no longer count against the marketing carrier. Thus, while Qantas is code sharing on JAL's daily Osaka-Brisbane-Sydney flights, it no longer requires the seven B767-200 units of capacity allocated to it by the Commission to enable it to do so.

1.3 Qantas also applied for a new allocation of 1.4 B767-200 units of capacity on the Japan route. That aspect of the application is the subject of separate consideration by the Commission. Qantas is seeking this additional capacity to be operated in conjunction with the seven B767-200 units of capacity that are the subject of the variation application to give it the necessary 8.4 units of B767-200 capacity it requires to operate the proposed seven B767-300 weekly services.

1.4 On 24 January 2001, the Commission published a notice inviting submissions from interested parties about the application. Submissions were received from the Australian Competition and Consumer Commission (ACCC), dated 25 January 2001, Ansett International (22 February 2001), and the Australian Tourist Commission (ATC) (23 February 2001). The ATC supported the Qantas application. Ansett International and the ACCC opposed the proposed variations.

1.5 In view of the opposing submissions the Commission, at its meeting on 5 March 2001, decided to consider the Qantas application against the additional public benefit criteria set out in paragraph 5 of the Minister's Policy Statement. Qantas and the three submitters were invited to make further submissions addressing the paragraph 5 criteria. Submissions were received on 20 March 2001 from the ATC, Ansett International and Qantas, and on 21 March 2001 from the ATC. Qantas made a second submission on 20

March 2001 specifically responding to issues raised in the earlier submissions from Ansett International and the ACCC.

1.6 Further submissions were received on 22 March 2001 (from the ACCC), on 21 March and 30 March 2001 (from Qantas), and on 29 March 2001 (from Ansett International).

1.7 On 12 April 2001 the Commission published a draft decision proposing to reject the application. There were five respondents to the draft decision - Qantas (submission dated 1 May 2001), the Australian and International Pilots' Association (AIPA) (submission of 3 May 2001), Ansett International (3 May 2001), the Department of Industry, Science and Resources (DISR) (May 2001) and the Tourism Task Force (TTF) (8 May 2001). The draft decision and the responses to it are discussed below.

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

2 Current services

2.1 Currently, Qantas, Ansett International and Japan Airlines (JAL) operate direct services on the Japan route.

2.2 Qantas operates the following weekly services:

- 7xB747 Sydney-Tokyo and vv;
- 7xB747 Cairns-Tokyo and vv (Japan Airlines code shares);
- 3xB767-300 Perth-Tokyo and vv
- 4xB747 Cairns-Nagoya and vv; and
- 3xB747 Sydney-Nagoya-Cairns-Sydney.

2.3 JAL operates the following weekly services:

- 7xB747 Sydney-Tokyo and vv;
- 7xB747 Brisbane-Tokyo and vv (Qantas code shares); and
- 7xB747 Sydney-Osaka-Brisbane-Sydney (Qantas code shares).

2.4 Ansett International operates 7xB747 services Sydney-Osaka and vv (All Nippon code shares).

2.5 Qantas currently has 7 B767-200 equivalent units of unused capacity per week to Kansai (the subject of its variation application). Ansett International has 8.4 B767-200 units of unused capacity which is to be used from 1 November 2002 or when slots become available at Narita airport, whichever is earlier, or from such other date approved by the

Commission.

3 Characteristics of the Australia- Japan route

3.1 The only data currently available for carriage after July 2000 is ABS estimates of short term visitor arrivals from Japan for the period from August 2000 to February 2001.

3.2 In the year ended 31 July 2000, traffic on the Australia – Japan route totalled approximately 1,782,100 passenger movements. Of these passenger movements, 78.8% were passengers with a destination of either Australia or Japan travelling directly between the countries (direct traffic). Some 9.0% of movements involved passengers travelling indirectly between the two countries (indirect traffic). The remaining 12.2% of the movements involved passengers travelling directly between Australia and Japan to and from countries beyond Japan and/or Australia (beyond traffic).

3.3 Direct traffic declined by 3.1% in the year ending July 2000, compared with an decline of 8.0% in the year ending July 1999. Both indirect and beyond traffic have grown over each of the last three years with beyond traffic increasing by 25.3% in the year ending July 2000.

Traffic category	Australia – Japan Passenger Movements Years Ended 31 July 1997 – 31 July 2000				Compound annual growth rate 97-00
	1997	1998	1999	2000	
Direct traffic (Annual % change)	1,591,800	1,574,400 (-1.1%)	1,448,400 (-8.0%)	1,403,700 (-3.1%)	(78.8%) -4.1%
Indirect traffic (Annual % change)	139,200	129,900 (-6.7%)	144,000 (+10.9%)	160,900 (+11.7%)	(9.0%) 4.9%
Beyond traffic (Annual % change)	151,000	168,800 (+11.8%)	173,700 (+2.9%)	217,600 (+25.3%)	(12.2%) 13.0%
Total traffic (Annual % change)	1,882,000	1,873,100 (-0.5%)	1,766,100 (-5.7%)	1,782,100 (+0.9%)	(100.0%) -1.8%

Note: Data in this table have been derived from information supplied by the Australian Bureau of Statistics and include both scheduled and charter traffic. Figures may not add to totals due to rounding. Average annual growth records the compound annual growth rate.

3.4 In the year ended 31 July 2000, Japanese residents comprised 91.1% of the passenger traffic with origin/destination Japan. Japanese residents visiting Australia did so mainly for holiday (85.5%), and for business (3.8%). Australians visiting Japan did so mainly for business (31.4%), for holiday (25.5%) and for visiting relatives (17.6%).

Short term visitor arrivals from Japan
August 2000 – February 2001
(000's)

	<u>1999</u>	<u>2000*</u>	Change
August	69.8	68.3	-2.1%
September	54.7	47.4	-13.3%
October	54.5	54.7	0.4%
November	57.8	68.9	19.2%
December	58.4	71.5	22.4%
	<u>2000</u>	<u>2001</u>	
January	50.3	60.6	20.5%
February	68.5	64.3	-6.1%
Total	414.0	435.7	5.2%

*Note: Data in this table for the period from August 2000 is estimated by the Australian Bureau of Statistics and include both scheduled and charter traffic.

3.5 The latest estimates provided by the ABS, included in the table above, indicate that there was strong growth in short term visitor arrivals from Japan in the November 2000 to January 2001 period. There was a 6.1% decline in February 2001.

3.6 The table below shows that Qantas' has the largest market share on the Japan route. Its share has held steady for the past two years after a small decline from 1997 to 1998. Ansett International's market share improved over the period from 1997, as did that of Japan Airlines, although the shares of both stabilised from 1999 to 2000. All Nippon's share has fallen to low levels, with its only current presence being marketed capacity on Ansett International's services.

Australia – Japan Origin Destination Traffic by Airline

Year ended July	1997	1998	1999	2000
Qantas Airways	46.8%	43.1%	42.4%	43.2%
Japan Airlines	27.6%	28.4%	31.1%	30.9%
All Nippon Airways	8.3%	10.7%	3.6%	0.4%
Ansett Australia	8.5%	9.3%	12.3%	12.7%
Other	8.7%	8.5%	10.5%	12.8%

Note: Data in this table have been derived from information supplied by the Australian Bureau of Statistics and include both scheduled and charter traffic.

3.7 In 2000 nearly 60% of all direct traffic (Department of Transport and Regional Services city pair data for 2000) between Australia and Japan was uplifted or discharged in Tokyo. Osaka had nearly 30% of the uplift discharge traffic and Nagoya 11%.

4 Provisions of relevant air services arrangements

4.1 The Australia-Japan air services arrangements were amended on 8 December 2000 so that capacity used in joint services is counted as units of capacity of the designated airline operating the aircraft. The corollary to this change is that capacity used by a marketing carrier in joint services is no longer counted against that carrier.

4.2 Operation of the capacity involved in this variation application to Tokyo is permissible under the capacity and route entitlements of the revised air services arrangements.

5 Applicant's proposal

5.1 With effect from June 2002, Qantas plans to introduce a new daily B767-300 service weekly between East Australia and Tokyo. It seeks to use its capacity allocation, currently restricted to services at Osaka, which was freed up by changes in December 2000 to the air services arrangements between Australia and Japan. As a result of those changes, capacity used by a marketing carrier is no longer counted against that carrier. Qantas has also sought an additional allocation of 1.4 B767-200 units of new capacity (as noted, this is dealt with separately by the Commission). In total, this would provide the 8.4 B767-200 units of capacity Qantas requires to operate its planned services.

5.2 Qantas submitted that its application was consistent with the paragraph 4 criteria of the Minister's Policy Statement and that the requested variations would be of benefit to the public.

Initial submissions in relation to the proposal

ACCC

5.3 In its submission of 25 January, the ACCC argues that the Qantas proposal to take advantage of changes to the Australia – Japan air services arrangements and future slots at the new runway at Narita would not necessarily be in the interests of competition on the Tokyo route or in the interests of the travelling public. The ACCC contends that it would seem appropriate that Qantas should hand back the 7B767-200 units of now unutilised capacity. This would allow other airlines to apply for the capacity, which could be used at Tokyo once slots became available, or sooner if used at other points in Japan.

Ansett International

5.4 Ansett International, in its 22 February submission, argues that changes to air services agreements should not have the potential to advantage one carrier vis a vis its competitors through "windfall" capacity gains. It considers that the public benefit grounds on which the original allocations were made are no longer relevant in such cases. Ansett International says it would be very concerned if the Commission were to set a precedent without scrutiny in this case. It says that similar changes are likely to other air services arrangements as further liberalisation occurs. Ansett International sees this as a significant matter of principle, particularly important in markets which are capacity constrained and

where competition is not well developed. Ansett International contends that the Commission should request Qantas to hand back the capacity in question.

5.5 Ansett International also raises the issue of slot access to runways at Narita airport, noting that B767 aircraft would be permitted to travel no more than 1,500 nautical miles from take-off from the new runway (Runway B). It believes there is scope for intervention in terms of allocation of slots on competition grounds. Ansett International draws this issue to the Commission's attention as a competition matter under the public benefit criteria, but indicates its intention to raise it as a policy matter with the Department of Transport and Regional Services and the ACCC.

ATC

5.6 The ATC points out that Japan is one of Australia's key source markets for inbound arrivals, with 720,000 arrivals in 2000 of which Tokyo and surrounds contribute about 50%. The ATC is keen to see a greater number of direct services from Tokyo to Australia. It supports the Qantas application as it believes direct daily services provide consumers with the flexibility and choices to assist in their decision to visit Australia.

Qantas' response

5.7 In the first of its two submissions of 20 March, Qantas responds to issues raised by the ACCC and Ansett International in their submissions of 25 January and 22 February respectively. In relation to Ansett International's submission, Qantas does not agree with Ansett International's claim that Qantas is attempting to benefit from a windfall gain and does not accept that there is a windfall gain involved. Qantas also disagrees with Ansett International's view that the Commission's original public benefits evaluations concerning Qantas' Osaka operations are no longer relevant, or that the capacity should be handed back for re-allocation. It notes that there is no intention that the latest application not be subject to scrutiny, noting that the application is being subject to a public benefit evaluation. Qantas also argues that the Commission's normal approach to variation applications should be adopted, specifically that if the application were approved, there would be at least the same level of public benefits as before the variation.

5.8 Qantas takes issue with Ansett International's concerns about the impact of the proposed variation in a capacity constrained market where competition is not well developed. Qantas points out that Ansett International has, in the past, held unused capacity at Osaka, and continues to do so at Tokyo (8.4 B767-200 equivalent units allocated by the Commission in June 2000), the latter being capacity which could potentially be used elsewhere until available for Tokyo.

5.9 Qantas considers that Ansett International's indication that it would give serious consideration to applying for the capacity, were it to be handed back by Qantas, lacks substance and commitment.

5.10 Qantas takes issues over Ansett International's argument that Qantas would have a competitive advantage through being able to take advantage of existing time slots at Narita Runway A, in order to avoid the operating limitations of Runway B. Qantas considers it would be in the same position as Ansett International. Qantas says that its 14 B747 services to Tokyo would not be permitted to use Runway B and therefore slots would not be saved

at Runway A. It also says that arrival slots may not automatically be converted to departure slots, which could prevent flexibility in relation to Qantas' three weekly B767 services Perth/Tokyo. Qantas also suggests that the proposed Runway B restrictions are likely to be temporary, with possible additional runway length in the future.

5.11 Finally, Qantas says it takes issue with Ansett International's apparent suggestion that action should be taken to remove some of Qantas' slots and hand them to Ansett International. Qantas argues that its current operations at Narita are not relevant to its variation application, pointing out that Qantas' current level of frequencies to Tokyo predated the creation of the IASC Act and the Government's multiple designation policy. Qantas makes several other points in relation to the slots issue, including noting that Ansett International has had several opportunities to seek access to Japan capacity. Qantas also states that the role of the Commission is to allocate bilateral capacity and that carriers secure slots through a separate process on different authority. Qantas argues that, should its application be declined, Qantas will be unable to take advantage of the limited opportunity to expand Tokyo operations using the new runway.

5.12 Qantas also expresses concerns about the ACCC submission of 25 January, which it suggests raises issues similar to those contained in Ansett International's submission. Qantas says it has a wider concern relating to the ACCC's suggestion about the desirability of giving other operators an opportunity to compete with Qantas for the capacity in question. Qantas argues that the ACCC is attempting, indirectly, to re-define the start up and new entrant provisions of the Policy Statement, which have been acquitted on the Japan route. It also considers the ACCC is focussing on the Australia - Tokyo market, when it should be taking a whole-of-route approach as required under the Policy Statement (that is, all points in the route schedule under the air services arrangements).

Summary of submissions in relation to the paragraph 5 criteria

5.13 The ATC indicates that it stands by comments in its earlier submission supporting a greater number of direct air services from Tokyo into Australia, noting further that the Commission has to assess policy and process issues which are beyond the role of the ATC to comment upon.

5.14 Qantas, Ansett International and the ACCC made substantive submissions in relation to the paragraph 5 criteria. These are summarised as follows:

Qantas

5.15 Qantas provides the Commission with detailed background information as a lead in to its claims against the paragraph 5 criteria. This information is not summarised here, but is taken into consideration in the Commission's assessment of the variation application.

5.16 Qantas claims against the paragraph 5 criteria are, in summary:

Tourism benefits

- Japan-Australia services are comprised predominantly of Japanese originating passengers and more than half of this traffic flows over Tokyo. Qantas has limited

scope to increase capacity to Tokyo within current frequencies. Additional services at Tokyo would provide better prospects for developing new traffic from the Tokyo catchment area and of diverting traffic from alternative tourist destinations to Australia, than if the capacity was operated into the smaller Osaka-area market. Qantas has not increased frequencies at Tokyo since October 1989, as a result of slot constraints.

- Qantas has a substantial and well established marketing presence, with sales offices in five Japanese cities. It employs 136 staff, mainly dedicated to sales and marketing, the majority of whom are in Tokyo.
- Qantas has well established relationships with wholesale/retail agents in Japan. Details are set out in confidential material supplied to the Commission.
- Qantas commits substantial expenditure to advertising and promotional activity in Japan, promoting its services and Australia as a destination. Details are given in confidential material provided to the Commission.

Australian consumer benefits

- Qantas quotes recent ABS figures for traffic carried on non-stop services between Australia and Japan showing that over 70% of Australian resident traffic travels to/from Japan on Tokyo flights. The largest component of this traffic is travelling for business related purposes. Tokyo is the commercial and financial centre of Japan and therefore the benefits to the Australian business market from additional frequency and capacity to Tokyo are superior to these flights being added to Osaka. Tokyo is well connected to other Japanese cities.
- The limited holiday market to Japan prefers to use Tokyo as its gateway.
- Passengers travelling to other destinations via Japan, with or without stopover, will have enhanced links with additional services at Tokyo rather than Osaka.

Trade benefits

- Australia's principal exporters of perishable food products would have an overwhelming preference for Qantas to add frequencies to Tokyo rather than Osaka.
- Tokyo is Qantas' preferred access point for import and export freight. Tokyo is the primary freight centre for Japan with major freight forwarders consolidating their activities there and most international freighter services operate to Tokyo. This means Tokyo is the preferred port for interlining freight. The distribution networks for handling imported perishable products, such as seafood, are largely centralised in Tokyo. Transport of mail is handled via the Tokyo mail centre.
- Qantas has high quality freight terminals in all Australian States. Automated export clearance and import pre-clearance systems provide expeditious handling of freight and documentation. Qantas has two terminals in Sydney dedicated to the import and export handling of airmail and express freight.

Benefits for the Australian aviation industry

- Qantas could make more effective use of the entitlements under consideration by operating to Tokyo rather than Osaka:
 - demand for the capacity will be greater at Tokyo, given market size and previously constrained access. The capacity would be more efficiently used with greater returns to Qantas.
 - if the variation application was rejected, Qantas would have no alternative but to operate the capacity to Osaka, diminishing returns to Qantas and adversely affecting the financial performance of the incumbent carriers through the additional capacity in the more limited Osaka market.
 - if the capacity is not operated to Tokyo, Qantas would be unable to secure additional timeslots for a new daily service to Narita when these become available with the opening of the new runway in summer 2002. Available slots are expected to be taken up rapidly. Qantas would also lose the opportunity to expand capacity by substituting larger aircraft for the B767-300 in future.

Competition benefits

- The Commission has already considered and made a capacity allocation to Qantas under this criterion. Whether the capacity is operated to one or other of the cities of Osaka or Tokyo, it is still operated on the Japan route as a whole, and therefore the capacity position on the route does not alter because Qantas wishes to operate to Tokyo rather than Osaka.
- The distribution of capacity and frequencies on the route (as a whole) will be more favourable to Ansett in 2002 than when the Commission's allocation decision was made in 1993. Although Qantas will have more flights to Tokyo than Ansett, this is not the central issue. Qantas cites the Commission's view in 1993 that competition is directed to the route as a whole rather than on particular city pairs within a route. Qantas also argues that the level of capacity operated by Ansett is to some extent based on that company's commercial decisions, rather than opportunities under the air services agreement. Further, the level of Qantas services is related to developments that pre-dated the IASC Act, and Qantas should not be penalised because it took the initiative to expand its services to Japan.
- Ansett could restructure its Osaka services and transfer some of its capacity to Tokyo.
- Qantas' competitive position on the Japan route could be impaired if its variation request is refused and Japanese carriers add new services to Australia when additional time slots become available at Narita. The Japanese carriers have sufficient unused entitlements to operate another 18 B747 services weekly between the two countries.

Ansett International

5.17 Ansett International reaffirms the view expressed in its earlier submission that, as a matter of principle, windfall capacity gains should be returned to the shelf for allocation on the basis of public benefit criteria. Ansett International indicates that if the seven units of capacity currently allocated to Qantas for use on the Osaka route were returned to the shelf, Ansett International would apply for 8.4 units of capacity to enable it to operate a second daily B767-300 services between Tokyo and a point on the east coast of Australia other than Sydney. Ansett International addresses the paragraph 5 criteria on the basis of benefits that it argues would arise through the operation of these services.

Tourism benefits

- Japan is Australia's second largest source of visitors to Australia. The Japanese market is showing signs of recovery after recent decline. A substantial presence on the route by an additional carrier has the potential to stimulate inbound tourism.
- As Ansett International would operate a second daily B767 service from Tokyo to a point in Australia other than Sydney, inbound traffic would have an increased choice of destinations in Australia, providing tourism flows to an additional region of Australia.
- Ansett International has successfully operated services to Osaka since September 1994. However, Tokyo was Ansett International's preferred point for serving the Japan market in the first instance, but limitations on slots at Narita prevented this. Ansett International maintains a sales and marketing presence in Tokyo and this is intended to be increased when Ansett International commences its daily service to Tokyo with the opening of the new runway at Narita in 2002. This presence would expand further with a second daily service. The Tokyo office would market and sell competitively priced fares and holiday packages.

Consumer benefits

- Australian resident traffic to Japan has grown at an average annual rate of over 5% in the three years to December 1999, due to increased business traffic. A second daily service would offer business travellers increased schedule choice and an alternative point of departure in Australia. Ansett International's service levels are recognised and awarded.

Trade benefits

- Japan is the number one destination for export of Australian goods, with \$1.4 billion of air freight exports. An additional Ansett International daily service would increase freight carriage opportunities at competitive rates. Exporters would have greater choice of schedules and point of origin. This is particularly important for perishable freight exports.

Competition policy

- Australia – Tokyo is served on a direct basis by Qantas and Japan Air Lines with 28 daily B747 services and 3 weekly B767 services in total. These carriers code share on each other's Brisbane and Cairns flights. Ansett International's entry to the Tokyo market with daily B767-300 services from Sydney in 2002 would give it about 10% of capacity operated to that city. A further Qantas service would diminish Ansett International's share. However, a second daily Ansett International frequency would bring its capacity share close to 20%, enabling it to compete genuinely with the Qantas/Japan Airlines partnership.
- Over 50% of Japanese visitors to Australia fly from Tokyo and the majority of business traffic originates from or is destined for Tokyo. It is important for Ansett International to increase its capacity share to Tokyo if it is to provide effective competition on the Japan route.
- A strong Ansett International presence at Tokyo would enable Ansett International to be more competitive for corporate accounts. It would offer inbound and outbound fares and packages that would contribute to price competition.
- The additional services would raise Ansett International's profile in the Japan market and enhance its ability to compete more broadly in international markets. Additional inbound traffic from these flights would increase Ansett's competitive ability with other Australian domestic carriers.

Industry structure

- A second daily service to Tokyo would strengthen Ansett International's position as an international carrier, enabling it to compete more effectively against foreign airlines and thereby contributing to the maintenance of a strong Australian aviation industry.

ACCC

5.18 The ACCC considers that there would be no competitive benefit, and possibly a competitive detriment, in the Australia – Japan market if the variations sought by Qantas were granted. Qantas and Japan Airlines (a Qantas code share partner) are the only carriers operating Australia – Tokyo. The variations requested could limit competition by denying any other Australian carriers interested in operating Australia – Tokyo the opportunity to apply for an allocation of capacity sufficient to enable them to be competitive.

5.19 Ansett International has expressed an interest in operating on the Tokyo route. While it has an allocation of 8.4 B767 weekly B767 units of capacity, which would enable it to operate daily B767 services, it would require additional units to operate a daily B747 service. It could only obtain the additional units by accessing the capacity for which Qantas has sought its variation.

5.20 Claims by Qantas as to benefits arising from the requested variations in the areas of tourism, consumers, trade and industry would need to be considered against the potential benefits in those areas from another Australian carrier entering the route and increasing competition on price and quality of service.

5.21 The ability of Qantas, relative to other operators to utilise slots should not be a factor in assessing the Qantas variation application. The relative ability of carriers to obtain slots could be relevant if the variations were not granted, the capacity was handed back and there were competing claims for unallocated capacity.

Further submissions

ACCC

5.22 On 22 March 2001, the ACCC addressed Qantas' statement of 20 March that the ACCC was taking a policy, as against a regulatory view, and attempting via an indirect means to re-define the start up and new entrant provisions of the Policy Statement. The ACCC states that it was responding in terms of the competition benefits of paragraph 5 of the Policy Statement, considering that the IASC's task is to compare public benefits associated with either granting or not granting Qantas' variation request.

5.23 The ACCC refers to its prior submissions making the point that, in terms of the competition benefit criterion of paragraph 5, not granting the variation could result in the benefit of increased competition on the Tokyo component of the Japanese route. It quotes the Policy Statement requirement that the IASC have regard to the number of Australian carriers using the capacity on a particular route and the existing distribution of capacity.

Qantas

5.24 In a submission received by the Commission on 30 March 2001 (dated 27 March), Qantas addresses Ansett International's submission of 20 March 2001 and the ACCC's submissions of 20 and 22 March 2001.

5.25 Qantas firstly reiterates several points from its earlier submissions relating to the procedures involved in assessing its application.

5.26 In respect of Ansett International's 20 March submission, Qantas contends that the arguments advanced by Ansett International against the paragraph 5 criteria, supporting a case for Ansett International to be granted further capacity on the Japan route, are not relevant to the Commission's decision. It disagrees with Ansett International's assertion that similar cases to this one will arise as air services arrangements change in future.

5.27 Turning to the ACCC submissions, Qantas argues that the ACCC submission of 20 March fails to examine the public benefits of Qantas operating to Narita instead of Osaka. Qantas says that the ACCC's conclusions are unsustainable, being based on the premise that the capacity would be available to another carrier for use at Narita, should the Qantas application be refused. Qantas also argues that the ACCC is showing itself prepared to make commercial judgements - judgements best left to market participants.

5.28 Qantas argues that the ACCC's 22 March submission does not contribute to a better understanding of the issues before the Commission. Qantas again argues that whatever the decision on the variation request, this will have no impact on the number of Australian carriers on the route or the existing distribution of capacity. The situation could only potentially change if Qantas chose to hand back the capacity.

5.29 Qantas concludes by arguing that the Ansett International and ACCC appear to be based largely on incorrect assumptions and have failed the test of demonstrating how public benefits would be reduced if Qantas operated to Tokyo rather than Osaka.

5.30 Qantas made a further submission on 4 April 2001 responding to issues raised in Ansett International's 29 March submission (see below).

5.31 Qantas says that Ansett International continues to assert that Qantas is in receipt of a windfall gain and that Qantas agrees that changes to the bilateral have the effect of increasing capacity. Qantas asserts that neither proposition is true and outlines its reasons. Qantas also disputes Ansett International's suggestion that there is a point of principle involved in this case which is relevant to other air services agreements. Finally, Qantas summarises what it sees as the ramifications of the Commission not approving the variation sought by the carrier.

Ansett International

5.32 In its 29 March 2001 submission, Ansett International comments on Qantas' submission of 20 March. Ansett International maintains that the seven units of capacity in question is windfall capacity and that it should be returned to the shelf for reallocation. Ansett International argues that, although the Government knew that changes to the air services arrangements would have the effect of increasing capacity, it does not necessarily follow that the Government considered Qantas should be automatically entitled to retain the capacity.

5.33 Ansett International maintains that the situation has not occurred before of changes to air services agreements resulting in windfall capacity gains on capacity constrained route, or where there has been potential for that capacity to be contested. Ansett International sees the Commission's decision as critical in terms of future equitable handling of similar situations.

5.34 Ansett International argues that in situations such as the current one, where rejection could result in capacity being returned to the shelf and two carriers are interested in the capacity, the benefit to the public would be greater if the Commission rejected the application.

5.35 Ansett International takes issue with Qantas' statement that Ansett International held unused capacity at Osaka for 20 months. Ansett International says that, had it not retained the capacity, the changes to the counting of capacity could have potentially resulted in the withdrawal of its services to Osaka.

5.36 Ansett International proposes that where windfall gains and unanticipated losses arise through bilateral changes, a solution would be to arrange transfers of capacity between carriers to maintain the status quo in terms of current operations. Any excess capacity arising should be returned for reallocation.

5.37 Ansett International argues that it is not attempting to rewrite and extend the new entrant rules, as Qantas contends. It agrees that the start up provisions have been acquitted. Ansett International says it is seeking to ensure that the case does not set a precedent for the

handling of future similar cases. It points out the value of new entrants spelled out in the Policy Statement and its Explanatory Memorandum.

5.38 Ansett International takes issue with Qantas' assertion that the Japan route as a whole should be considered, rather than a comparison of benefits between services at Osaka and Tokyo, noting that Qantas clearly differentiates Tokyo from other segments of the Australia – Japan route. It notes a February 2000 decision by the Commission where the Commission drew a distinction of this kind.

5.39 Ansett International makes clear its intention to apply for the capacity should it be handed back. It says it has more specific plans than Qantas for the use of the capacity. Clarification of slot issues at Government technical talks will enable Ansett International to be more specific about its operating plans.

5.40 Ansett International dismisses as irrelevant Qantas' expressed concerns about the currently unused Ansett International capacity allocation awarded to Ansett International in June 2000. Ansett International notes that the Commission did not require Ansett International to utilise the capacity until the second runway at Narita was operational. Ansett International says it has made clear its preference to operate to Tokyo over other Japanese points such as Fukuoka.

5.41 Ansett International concludes by asserting that it is able to offer utilisation of the capacity in question to Tokyo, as Qantas is, but Ansett International additionally offers the greater public benefits associated with increased competition.

Responses to the draft decision

5.42 In its draft decision, the Commission proposed to confirm determinations IASC/DET/9804 and IASC/DET/9910. As noted above, five submissions were received in response to the draft decision. These are summarised as follows:

Australian International Pilots' Association

5.43 AIPA submits that approval of the application would enhance the stability of employment of Qantas' technical aircrew. AIPA argues that the Commission has not taken into account the potential for increased growth in services to Tokyo when considering the public benefits associated with Qantas' proposal.

Department of Industry, Science and Resources

5.44 DISR states that if the Commission's decision was to stand and Qantas was to operate the capacity in question to Osaka, the effect could be that Australia loses the potential to operate seven additional units of capacity out of Narita in the future. DISR argues that this outcome would appear unlikely to maximise net tourism benefits. The Department argues that slots at Narita are valuable and Australia should not give up the possibility of access in terms of either current or potential use. Rather, it should endeavour to maximise its chances of obtaining all potentially available slots at Narita.

5.45 DISR's preference is to see an outcome whereby the additional potential slots at Narita are retained by an Australian carrier in a way that would at the same time boost airline competition on the route. However, if this objective is not possible, DISR would encourage exploration of outcomes which will ensure slot access for Australia, even if this means that the competition outcome may be less than optimal in this particular case.

Tourism Task Force

5.46 The TTF outlines the importance of the Japanese market to Australian tourism and states that Tokyo offers the best prospects for tourism growth to Australia. The TTF cites Qantas as saying that, if its application (to vary) is denied, the capacity will not be offered up by Qantas. Accordingly, there is very little prospect of Australian carriers being able to add new capacity to Tokyo. Rejecting Qantas' proposal will effectively cut the tourism industry off from potential revenue streams. The TTF says it is interested in the continued viability of Ansett's services on the Japan route. However, it is also concerned that the Australian tourism industry maximises its access to strategically important markets. The TTF would oppose confirmation of the draft decision if the IASC could not guarantee that Australian carriers will be able to maximise opportunities at Narita. The TTF recommends the draft decision be reviewed with a greater focus on the economic benefits to the Australian economy and the tourism industry.

Ansett International

5.47 Ansett International supports the Commission's draft decision. Ansett International says that where a carrier elects not to hand back capacity gains (obtained as a result of a bilateral change) there is a potential for public benefits arising from use of such capacity to be foregone, particularly in capacity constrained markets such as Japan. Ansett International welcomes the Commission's intention to develop conditions for attachment to future capacity allocations which would require the return of the capacity in similar cases.

Qantas

5.48 Qantas says that the purpose of its submission is to demonstrate that an incorrect balance has been struck by the Commission in weighting the outcomes against the public benefit criteria set out in the Minister's Policy Statement.

5.49 Qantas advises that it would use the capacity in question at Osaka, should the Commission confirm the draft decision, although that would not be its preference. It says it would resume operations at Osaka from the commencement of the Northern Winter 2001 season.

5.50 Qantas outlines what it sees as the adverse consequences if the Commission declines Qantas' application to vary its Osaka capacity allocations. These are:

- Timeslot access at Tokyo is limited in volume and timing. Qantas claims that the available slots at the second Narita runway would be rapidly taken up and carriers not taking up access in 2002 will miss out. The Commission would be delivering an outcome whereby access to slots would not be maximised;

- Capacity expansion at Narita will be blocked. Qantas notes that, initially, the limited length of the second runway at Narita will mean that B747 operations would not be permitted. Limiting frequencies at the runway now will block the opportunity for B747s to be substituted for smaller aircraft types in the future;
- Opportunities for tourism at Japan would not be maximised. If the Qantas application is rejected, scarce capacity to Japan would be diverted to a destination (Osaka) with lower tourism and growth potential.
- Expansion at Osaka is unlikely to be constrained, unlike at Tokyo. If Qantas was able to implement its plan for daily services to Tokyo, there is no suggestion from the Japanese authorities that additional flights to Osaka would not be permitted. In this way, benefits could be derived from operation of additional services to both points. Such an opportunity will not be available in reverse.
- Opportunities under the Australia – Japan air services arrangements would not be maximised.
- The effect on Qantas would be negative. Qantas would be adversely affected in the short and longer term by a negative Commission decision, including through Qantas' competitive position at Tokyo being diminished.

5.51 Qantas makes observations concerning the Commission's findings in its draft decision in relation to the paragraph 5 criteria of the Minister's Policy Statement. Qantas prefaces these by suggesting that the Commission considers that the seven units of capacity at issue should only be permitted to be operated to Tokyo by a carrier other than Qantas.

- Tourism. Qantas says the Commission has disregarded its finding that there would be greater tourism benefits generated if Qantas operated the capacity in question to Tokyo rather than Osaka. This is counter to Australian Government policy initiatives in support of Japanese tourism and fails to have regard to several aspects of the Japan market, the relative importance of Tokyo and Qantas' established presence and ability to generate new traffic from Australia to Japan.
- Australian consumer benefits. Qantas argues that the Commission should have placed greater emphasis on this criterion. The airline points out that the volume of Australian traffic is substantial, Tokyo is the main gateway for this traffic, and the proposed Qantas services would provide additional services for business travellers.
- Trade benefits. Qantas says the Commission chose to ignore in its weightings its finding that there would be greater trade benefits if the capacity was operated to Tokyo. The importance of Tokyo as the handling, marketing and distribution centre for Australian exports cannot be underestimated. A greater choice of frequencies and increased capacity to Tokyo is to be encouraged rather than impeded.
- Industry structure. Qantas considers the Commission should give emphasis to the flow on consequences to Qantas specifically, rather than to the wider industry

only. Qantas identifies several consequences which would arise if the capacity is required to be operated to Osaka rather than Tokyo.

- **Competition.** Qantas doubts that it was ever the intention of the Minister's Policy Statement to shield a particular carrier from competition. It considers that the Commission does not sufficiently take into account that Qantas' position on the Japan route is the result of its historical commitment.
- **Competition - analysis of capacity shares.** In responding to the Commission's analysis of capacity shares, Qantas argues it is inevitable that Qantas' capacity share will be higher than Ansett's. It considers that: the Commission has given too little emphasis to the fact that overall capacity shares are no different irrespective of whether Qantas operates to Tokyo or Osaka; the analysis disguises Ansett's true capacity share as Ansett chooses to sell Japan capacity under code share to All Nippon; the Commission ignores the prospects for new services by Japanese and third country airlines, noting that Japanese carriers take up of any of this would reduce Qantas' capacity share overall; new services by All Nippon would give Ansett a vehicle to market additional services; Ansett is not precluded from operating B767-300s daily to Osaka and releasing rights for use at Tokyo; and the Commission should regard Japan Airlines as a full competitor on the Japan route.
- **Competition – retarding Qantas' growth.** Qantas considers that the Commission's approach is inequitable and does not appear consistent with the Policy Statement. It notes that the start up provisions of the route have been extinguished and Ansett should not be regarded as a new entrant. Qantas argues that the Commission did not seek to retard Qantas' growth when making its original decisions on the allocation of capacity for Osaka. Qantas considers that in some respects the Commission is treating the Qantas proposal as if it was a new allocation. Preventing Qantas from using its allocations to secure a reasonable growth in entitlements would be inconsistent with paragraph 3.6 of the Policy Statement.

5.52 Qantas makes several points in concluding its submission. It considers that the Commission has erred in weighing the benefits under the Policy Statement criteria. Qantas indicates that, if forced to, it will operate the capacity in question to Osaka. Qantas sees the Commission's decision as sacrificing a potential additional daily B747 service to an airport with a continuing shortage of runway capacity. Qantas considers that there would be adverse effects on the Australian tourism industry, travellers, exporters and Qantas if the Commission's decision was negative to Qantas.

5.53 Qantas expresses particular concern about the Commission's suggestion that Qantas should surrender the seven units for reallocation. Qantas considers it to be unreasonable and without precedent for Qantas to be expected to surrender rights so the capacity can be subjected to a second competitive allocation process.

Other correspondence

5.54 The ACCC wrote to Qantas on 11 May 2001, copied to the Commission, advising that, if Qantas was to re-enter the Osaka market under a code share arrangement whereby Qantas was the operating carrier on the route and Japan Airlines was the marketing carrier,

such an arrangement could be at risk of breaching s.45 of the *Trade Practices Act 1974*. The ACCC states that such a code share arrangement could have the purpose or effect of denying other Australian airlines the opportunity to access capacity on the route between Australia and Japan.

5.55 Qantas wrote to the Commission on 17 May 2001 expressing its view that the matters raised in the ACCC's letter had no bearing on the Commission's consideration of Qantas' variation application.

6 Commission's assessment

6.1 There has been a number of instances over recent years of changes to bilateral air services arrangements which have resulted in allocated capacity becoming unused. This occurs in situations where bilateral capacity entitlements change in such a way that code share capacity is no longer deemed to be an exercise of capacity entitlements where it is used by a marketing carrier. Typically, carriers, including Qantas, which have held such allocated capacity have returned it to the Commission on their own initiative. Carriers have done this because they can continue to operate their code share services, without any longer requiring an allocation of capacity to do so. This approach to returning capacity is consistent with the intention of the *International Air Services Commission Act 1992* that allocated capacity should be fully used. Capacity returned in this way becomes available for reallocation in accordance with the Commission's normal procedures.

6.2 Qantas is obliged to take action in respect of its allocation at Osaka, because it now has unused capacity as a result of the changes to the air services arrangements with Japan. In the present case, Qantas has sought to vary its original determinations to enable it to continue to use its allocated capacity, rather than return the capacity for reallocation, even though it is able to continue operating its code share services with Japan Airlines to Osaka without this allocation.

6.3 The Qantas action is unusual in the light of previous practice whereby unused capacity created by bilateral changes has typically been returned for reallocation. However, there is nothing in the original determinations which require Qantas to return the capacity as a result of such a change in the bilateral. Indeed, Qantas could have elected to commence own aircraft services to Osaka in accordance with its original determinations without reference to the Commission. However, in this case, Qantas has been required to seek a variation from the Commission to facilitate its plans because the original determinations limit Qantas to operating the capacity in question to Osaka, and not to any other points on the Japan route. Qantas wishes to add services to Tokyo.

6.4 The Commission notes that, even without the changes to the bilateral arrangements with Japan, Qantas would have been faced with a decision about what to do with its allocation. The most recent variation to its original determinations authorised continued code sharing on these services only for an additional 12 months until 31 March 2001 (Decision [2000] IASC 203). The Commission recalls that, in authorising this extension of code sharing, it outlined its expectation that Qantas would subsequently revert to own aircraft operations, or there would be an opportunity for prospective applicants to develop proposals for the use of the capacity. As noted above, by virtue of the bilateral changes, Qantas is now able to continue code sharing, without requiring any renewed endorsement by the Commission.

6.5 In effect, the change in the bilateral arrangements has given Qantas the opportunity to add new own aircraft services to its total level of services on the Japan route, without any allocation of new capacity by the Commission. The Commission views this situation with concern given that capacity on the Japan route is heavily constrained. The Commission would have preferred to see the capacity returned immediately for reallocation, in line with previous practice on other routes. However, given that there is a variation application from Qantas, in accordance with s.24(1) of the Act, the Commission must make a decision either confirming the (original) determinations or varying the determinations in a way that gives effect to the variation requested in the application.

Paragraph 4 issues

6.6 Under paragraph 4 of the Policy Statement, the relevant criteria to be applied in deciding whether or not to allocate capacity is whether Qantas is reasonably capable of obtaining the necessary approvals and of implementing its proposals. Qantas is an established international carrier operating services to Japan. The ability to operate the services in practice would depend on the airline attaining the necessary slots at the new runway at Narita. The Commission has no reason to believe that Qantas would not be able to obtain the slots if its variation request was granted. The Commission considers that Qantas would be capable of obtaining the necessary approvals and of implementing its proposal.

Paragraph 5 issues

6.7 As there were submissions opposing the Qantas variation application, the Commission has decided to utilise the additional public benefit criteria contained in paragraph 5 of the Policy Statement in assessing the application, consistent with the provisions of paragraph 6.3 of the Policy Statement. Under paragraph 6.3, the additional criteria in paragraph 5 may be applied, whether or not such criteria were previously applied in considering the allocation of the capacity, where submissions are received about or opposing the variation requested.

6.8 In relation to the paragraph 5 criteria, the Commission has to decide whether the variation sought to the determination would be of benefit to the public. As the Commission has stated previously, it does not see this as requiring a finding that the variation will provide additional benefits. Rather, the Commission's task is to decide whether the proposed variation would produce at least the same level of public benefits as exists under the current determination. If a reduced level of public benefits may result, then the application should be rejected.

6.9 This definition of the Commission's task is important. It requires that the Commission compare the public benefits arising from two alternative scenarios of operations by the applicant – exercise of the capacity at Osaka under existing determinations, or exercise of the capacity at Tokyo as proposed in the variation application.

6.10 The Commission cannot compare the potential benefits associated with the operation of the capacity by another Australian carrier with benefits arising from the proposal of the

applicant, as the basis for making its decision in the variation application. This is because the capacity is not presently available for allocation to any carrier other than Qantas, which currently holds it under its existing determinations. The capacity is only likely to become available should the original variations be confirmed and Qantas was not to resume the exercise of the allocated capacity at Osaka. If this occurred, the Commission would expect the capacity to be returned promptly by Qantas for reallocation. Were Qantas not to return it in these circumstances, the Commission could institute a review of the determinations on the basis that the carrier no longer intended to fully use the capacity.

6.11 If the capacity was to be returned, the sorts of public benefits Ansett International and the ACCC have suggested might arise associated with a new carrier operating in the Tokyo market would be assessed by the Commission in the usual way, as part of a new allocation process. The Commission notes that Ansett International has expressed a definite intention to apply for the capacity were it available for reallocation. Other Australian carriers would also have the option of applying for the capacity if such a situation arose.

6.12 In summary the Commission emphasises that it is not evaluating the merits of another Australian carrier serving Tokyo but rather it is evaluating the public benefit of Qantas serving Tokyo compared with serving Osaka using the relevant capacity.

6.13 Although the task of the Commission is to determine the overall effect of the proposal in terms of public benefit, it is convenient to set out the Commission's consideration of public benefit using the structure of paragraph 5 of the Policy Statement. In practice, each element of public benefit impacts on the others and cannot be neatly compartmentalised.

Tourism benefits

The extent to which proposals will promote tourism to and within Australia. The Commission should have regard to:

- *the level of promotion, market development and investment proposed by each of the applicants, and*
- *route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s)*

6.14 The Commission is aware that limited capacity remains available for allocation on the Japan route. This situation is compounded by access limitations at Tokyo, where restrictions on slot access seem likely to prevent or at least severely restrict the expansion of Australian services at that city until the opening of the second runway at Narita in mid-2002. For example, additional capacity allocated to Ansett International for operation on the Japan route cannot be used at Tokyo until slots are obtained. Qantas says that it has not increased frequencies at Tokyo since 1989 due to slot constraints. Opportunities to expand capacity into Japan, and Tokyo in particular, are therefore highly valuable for carriers. These opportunities are particularly valuable to the tourism industry because of the predominance of Japanese tourists on the Australia – Japan route. Accordingly, the ATC is keen to see an expansion of direct services from Tokyo to Australia. This view is echoed in the submissions on the draft decision from the TTF and DISR.

6.15 The Commission considers that there is scope for additional services from Tokyo to more easily draw in tourists than may be possible if the extra services were operated at Osaka. Figures available to the Commission suggest that Tokyo accounts for about twice the amount of uplift/discharge traffic on the Australia – Japan route as Osaka. Capacity and slot access constraints at Tokyo also suggest that there may be some unmet demand for travel from that region.

6.16 The general outlook for tourist travel from Japan has shown recent signs of improvement, compared with the situation in February 2000 when the Commission granted Qantas' request for an extension of its code sharing authority with JAL. In granting that request, the Commission noted that traffic at Osaka was not forecast to grow strongly in 2000.

6.17 ABS figures available to the Commission now show that overall traffic on the Japan route as a whole did indeed continue to be weak through most of 2000. However, in November and December 2000 and in January 2001, there was strong growth in visitor arrivals in Australia from Japan - over 20% for each month compared with the corresponding period a year earlier. There was evidence of weakening in the February figures. While it is too early to draw definite conclusions from results in this short period, there does appear to be cause for greater optimism about the traffic outlook than was the case in early 2000. Assuming the signs of a return to growth continue and growth is uniform across the Japanese market, then there should be scope for Qantas to benefit from this at Osaka if it were to return to own operated services there.

6.18 Qantas has a strong marketing and sales presence in Tokyo and devotes substantial resources to promotion and market development. The majority of Qantas' staff are in Tokyo and this is to be expected given that the focus of most of Qantas' services is on that city. The Commission considers that Qantas could devote an equivalent level of resources to Osaka. However, given the economic profile of the Tokyo area compared with the Osaka area, Qantas' promotional resources may be more fruitful in the Tokyo market.

6.19 On balance, the Commission considers that there are likely to be greater tourism benefits through the operation of the services in question at Tokyo rather than at Osaka.

Consumer Benefits

The extent to which proposals will maximise benefits to Australian consumers. The Commission should have regard to:

- *the degree of choice (including, for example, choice of airport(s), seat availability, range of product);*
- *efficiencies achieved as reflected in lower tariffs and improved standard of services;*
- *the stimulation of innovation on the part of incumbent carriers; and*
- *route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s).*

6.20 The outbound component of traffic on the Japan route is small, comprising less than 10% of total traffic. However, the Commission recognises that a significant component of Australian consumer traffic has a business purpose, and that Tokyo is the principal Japanese business centre. The Commission concludes that additional benefits are likely to be associated with the operation of Qantas' proposed services to Tokyo, in comparison with Osaka.

6.21 While important, the small size of this market segment means that potential benefits in this area are likely to be *relatively* small in comparison with those affecting the bulk of the market, which is inbound to Australia. This criterion therefore has less importance in the Commission's view, in this particular case, than do the tourism and competition criteria in particular.

Trade Benefits

The extent to which proposals will promote international trade. The Commission should have regard to:

- *the availability of frequent, low cost, reliable freight services for Australian exporters and importers.*

6.22 Qantas makes a strong case for trade benefits associated with additional services at Tokyo. The Commission agrees with Qantas that there would be comparatively greater benefits associated with the operation of additional services to Tokyo in comparison with Osaka, given the primacy of Tokyo as a freight handling and distribution centre in Japan. Qantas has high quality handling facilities in Australia, although these would be equally beneficial to exporters whether services were operated to Osaka or Tokyo.

Competition Benefits

The extent to which proposals will contribute to the development of a competitive environment for the provision of international air services. The Commission should have regard to:

- *the need to develop strong Australian carriers capable of competing effectively with one another and the airlines of foreign countries;*
- *the number of Australian carriers using capacity on a particular route and the existing distribution of capacity.*
- *the extent to which applications are proposing to provide capacity on aircraft they will operate themselves as, in the long term, operation of capacity on own aircraft is likely to result in more competitive outcomes;*
- *the provisions of any commercial agreement between an applicant and another airline affecting services on the route but only to the extent of determining comparative competition benefit between competing proposals;*
- *any determinations made by the Australian Competition and Consumer Commission or the Australian Competition Tribunal in relation to a carrier operating or proposing to operate on all or part of the route; and*

- *any decisions on notifications made by the Australian Competition and Consumer Commission in relation to a carrier operating or proposing to operate on all or part of the route.*

6.23 Qantas submits that the Commission has already considered and made a capacity allocation to Qantas under this criterion and whether the capacity is operated to Osaka or Tokyo it is still operated on the Japan route. Therefore the capacity position does not alter whichever port the capacity is operated to. The Commission does not accept Qantas' view.

6.24 The very nature of Qantas' application and the associated requirements of the Act mean that the Commission must compare benefits under the current determinations (ie. capacity operated at Osaka) with those arising if the variation request was granted (ie. capacity operated at Tokyo). In relation to this criterion, this means the Commission must look at the competitive implications of the capacity being operated in the Osaka market as compared with the Tokyo market. This is the situation in respect of the other paragraph 5 criteria and this criterion is no different.

6.25 Qantas rightly points out that much of its Japan route allocation predates the establishment of the Commission. Nevertheless, the paragraph 5 criteria make it clear that the Commission should take account of "the number of Australian carriers using capacity on a particular route and the existing distribution of capacity". Closely related to this, the Commission should have regard to "the need to develop strong Australian carriers capable of competing effectively with one another and the airlines of foreign countries".

6.26 Opportunities for expansion of capacity, and hence increased competition, in the Japanese market by Australian carriers are limited. As noted earlier, this situation exists because of a lack of negotiated capacity, compounded in the case of Tokyo by physical access restrictions.

6.27 Clearly, in these circumstances, determinations allocating capacity which alter the balance of opportunities between Australian carriers, or which may have a significant impact on the development of strong, competitive Australian carriers, can carry long term consequences. This is especially so where there are likely to be limited opportunities to address any adverse consequences through future determinations.

6.28 Taking these issues into consideration, the competition implications are clearly of very substantial significance in this case.

Capacity shares on the Japan route as a whole

6.29 The Commission is mindful that, of the two Australian carriers operating on the Japan route as a whole, Qantas holds the major share of capacity. Currently Qantas holds over 48% of direct Japan capacity, calculated as the number of marketed seats it operates in the market, compared with the other Australian carrier on the route (Ansett International) with 7%. The remainder of the capacity is held by Japanese carriers, with Japan Airlines the only Japanese carrier actually operating. The Commission understands that some 37 B767-200 units per week of capacity available to Japanese carriers remains unutilised and there are currently no known proposals for utilisation of this capacity.

6.30 Calculated on the basis of operated capacity only, Qantas still has over three times the share of Ansett International, with over 44% of total capacity and Ansett International 14%. Qantas' marketed capacity exceeds its operated capacity because of the code sharing arrangement it has with Japan Airlines. Ansett International could lift its share of marketed capacity to the level of its operated capacity if it were to cease code sharing with All Nippon.

6.31 The Commission also notes that Japan Airlines, Qantas' code share partner on a significant proportion of services, holds nearly a further 38% of total Japan route capacity. Qantas and Japan Airlines between them hold a dominant share of total capacity, with 86% of the total Japan market compared with Ansett International and All Nippon (Ansett International's code share partner) with a total of just 14%.

6.32 Qantas argues that Qantas and Japan Airlines are competitors on the route, and the Commission recognises that the two carriers do not code share on all of each others' services, but the extent of their code sharing is still substantial. The dominance of these two carriers, and the implications of this for competition on the Japan route (and the Tokyo market in particular), is an issue about which the Commission has expressed concerns in previous decisions. Those concerns remain.

6.33 Focussing on the distribution of capacity shares between the two Australian carriers on the Japan route, the relative shares of the two carriers will alter with a start up of Ansett International's proposed Tokyo services from mid-2002. If nothing else changes, this would lift Ansett International's total marketed capacity share to nearly 14%, with Qantas' share falling to just under 45%. This would still leave Qantas with over three times the total marketed capacity of Ansett International.

6.34 Should the Commission authorise the variation sought by Qantas, that would lift Qantas operated/marked capacity share on the Japan route to over 48%, with Ansett International's share then declining to under 13%, even with the new Ansett International services at Tokyo from mid-2002. However, the Commission recognises that this capacity distribution would also result if Qantas resumed own operated services at Osaka and continued selling code share seats on Japan Airlines services to Osaka, if the variation request was declined. This ability for Qantas to increase its operated/marked capacity share on the Japan route without any further allocation of capacity by the Commission, is a direct consequence of the recent changes to the bilateral arrangements. Whether or not this result is described as a windfall gain for Qantas, as both Ansett International and the ACCC have called it, the outcome alters the balance of opportunities between the Australian carriers on the Japan route. It does so in favour of the carrier which already has the distribution of capacity very much in its direction. This situation is one the Commission views with concern.

Capacity shares in the Tokyo market

6.35 The situation in the Tokyo market is of particular concern to the Commission. The relative and absolute importance of the Tokyo market as a component of the Australia – Japan route is substantial, as has been highlighted in Qantas' own submissions and those of all other submitters. Currently no Australian carrier other than Qantas has a presence at Tokyo. Qantas and Japan Airlines operate 100% of the direct capacity between Australia and that city. They code share on 14 B747 services per week into this market which

represents about 40% of the services to Tokyo. A decision by the Commission to grant Qantas' variation request would substantially affect the distribution of future opportunities in the Tokyo market, as the following analysis shows.

6.36 With the commencement of Ansett International's Tokyo services in mid-2002, Ansett International would have nearly 12% of the capacity share in the Tokyo market. Authorisation of the Qantas variation would reduce Ansett International's share to under 11%, with Qantas then having nearly 53%. Qantas argues that Ansett International could seek the Commission's approval to move some of its Osaka capacity to Tokyo, as Qantas is proposing. This is theoretically possible, but the practicalities are quite different. Qantas does not have to take any operated services away from Osaka to enable it to add more services at Tokyo. Ansett International would have to do so. For example, Ansett International could substitute B767 services for its B747s at Osaka and operate new B767 services to Tokyo, subject to obtaining a variation approval from the Commission if it wished to move more than four B767-200 equivalent services under current determinations. Clearly the commercial considerations for the two carriers are quite different.

Overall assessment

6.37 As matters stand, Qantas clearly has a dominant share of capacity in the Japan route as a whole, relative to Ansett International, the only other Australian carrier on the Japan route. The situation is even more skewed in Qantas' favour in the Tokyo market, the most important market on the Japan route. Combined with the competitive influence of Qantas' code share partner, Japan Airlines, the competitive position of Ansett International, or any new entrant Australian carrier on the Japan route, has the potential to be tenuous.

6.38 By virtue of the bilateral changes, the overall distribution of capacity would shift further in Qantas' direction whatever decision the Commission makes on this application, and assuming Qantas was to operate its own services to Osaka if the variation requested was not approved. Such an outcome is likely to act to the detriment of other Australian carriers. However, the grant of further capacity to Qantas at Tokyo, would, in the Commission's view, be even more likely to affect detrimentally the competitive position of other Australian carriers because of the greater relative concentration of Qantas' capacity at that city

6.39 The Commission found in its decision in February 2000 ([2000] IASC 203) that there would be a greater public benefit were Qantas to revert to serving Osaka in its own right, compared with code sharing. From a competition viewpoint, the Commission continues to see benefits in Qantas resuming own operated flights to Osaka, particularly in comparison with adding further flights to Tokyo instead. It has been a consistent view of the Commission that own aircraft operations are to be preferred to codesharing. If it was to resume own operated services to Osaka, Qantas could decide to continue its code sharing arrangement with JAL (Qantas no longer needs the Commission's approval to code share following the changes to the air services arrangements). While the public benefits may be greater in the event Qantas ceased code sharing, competition benefits would arise in either situation as a result of the own operated services.

6.40 Qantas has raised concerns that its competitive position could be impaired if its variation request is refused, relative to Japanese carriers if those airlines were to add more

services to Narita when additional slots become available. The Commission does see a competitive risk in such a development, but the risk is far more likely to be carried by Australian carriers other than Qantas. The Commission considers that the risks to Qantas are small, especially given the size of Qantas presence at Tokyo, combined with the fact that the main Japanese competitor is Qantas' code share partner.

6.41 The Commission concludes that there is likely to be very substantially reduced public benefit in respect of competition if the Qantas proposal was to be approved.

Industry Structure

The extent to which proposals will impact positively on the Australian aviation industry.

6.42 The Commission considers that there is likely to be little difference in the flow on consequences to the wider Australian aviation industry between the capacity being operated at Tokyo compared with Osaka. In terms of the impact on Qantas, the Commission accepts Qantas' statement that it would be able to operate more profitably to Tokyo than to Osaka. However, the converse impact is that the profitability of other Australian carriers on the Japan route may be detrimentally affected by additional Qantas services to Tokyo. In net terms, the proposal is likely to have little or no positive impact on the Australian aviation industry.

Slots

6.43 Both Qantas and Ansett International have raised the issue of slot access at Narita. Ansett International considers this to be a competition policy issue and has raised the possibility of Qantas being obliged to hand back slots to facilitate access by other Australian carriers. Ansett International indicates that it proposes to raise the matter with the ACCC and the Department of Transport and Regional Services.

6.44 In making its recent determination ([2000] IASC 114) in favour of Ansett International, the Commission left the matter of obtaining the slots necessary to operate in the hands of the carrier to pursue through the established slot co-ordination mechanism. Should Ansett International not be able to obtain slots, then it would be obliged to return the capacity for reallocation.

6.45 The Commission does not allocate slots and the corollary is that it should not seek to require a carrier to give up slots, even assuming it has the authority to do so, which the Commission has not sought to establish at this stage. The matter of slots is one on which the aeronautical authorities of Australia and Japan are in dialogue.

6.46 The Commission has carefully considered the arguments relating to slot access put by Qantas in support of its application to operate to Tokyo. Qantas argues that granting its application will enable it to secure additional slots at Tokyo for operation at the new runway – a once-off opportunity that will be lost if the application is not approved. The Commission recognises that slot access at Tokyo is very limited. However, as is explained earlier, the Commission's task is to look at the relative public benefits of operating the capacity at Osaka compared with operating it at Tokyo, as it has done in the preceding

analysis. The issue of slot access is important, but should not override full consideration of the proposal in public benefit terms.

Conclusion

6.47 The Commission considers that there would continue to be public benefits associated with Qantas exercising its allocated capacity at Osaka in accordance with its original determinations.

6.48 There would be public benefits derived against some of the paragraph 5 criteria from granting the variations sought by Qantas, particularly in terms of tourism benefits. However, the likely anti-competitive consequences of granting the application, in the Commission's view, outweighs those other potential benefits. The Commission is especially concerned that the existing imbalance in the distribution of capacity in the Tokyo market would be exacerbated and the ability of other Australian carriers to develop in order to compete effectively with Qantas and foreign carriers would be weakened. The Commission considers that Qantas' substantial presence in the market means that its ability to compete effectively with foreign carriers would not be impaired if it was unable to add the extra capacity to Tokyo as it has sought. It has some scope in the future to expand its own market presence at Tokyo by reducing code sharing by Japan Airlines on Qantas' services, should it elect to do so. Taken together, the Commission concludes that granting the variation would be likely to lead to a lessening of public benefits compared with those available from the original determinations. Under s.24(2) of the Act, the Commission must not make a decision varying the determination unless it is satisfied that the allocation of capacity, as so varied, would be of benefit to the public. In these terms, the Commission is unable to satisfy itself that the variation proposed by Qantas would be of benefit to the public.

6.49 The Commission considers that the scheme of the Act is aimed at ensuring that allocations of capacity should be made on the basis of the greatest benefit to the public. In this case, Qantas is effectively seeking to operate additional capacity at Tokyo, through the technical process of the variation application. While, as the Commission has noted above, the applicant's proposal is consistent with the Act, the Commission would have preferred to see this capacity available for a competitive allocation process. Accordingly, the Commission's preference would be to see Qantas return its Osaka capacity, which it is not presently using and has not used since the changes to the air services arrangements in December 2000, pending the consideration of its current application.

6.50 The Commission will confirm the original determinations. It will require Qantas to advise within one month from the date of this decision, whether or not it will resume own aircraft services to Osaka and, if so, from which date.

6.51 The Commission will allow Qantas some operational flexibility to resume services to Osaka, if that is its intention. It will require Qantas to commence services no later than from the beginning of the Northern Winter 2001 scheduling period.

6.52 If, at the end of the one month period referred to in paragraph 6.50 above, Qantas advises that it does not intend to resume services to Osaka, the Commission requests that

Qantas apply immediately to the Commission to return the capacity involved, for reallocation on the Japan route.

6.53 In closing, the Commission places on record its concern at the situation which has arisen in this case. Qantas has acted within its rights under the Act in seeking to vary its Osaka determinations and, indeed, is within its rights to resume own aircraft operations at Osaka should it wish to do so. However, the Commission does consider that Qantas has been handed an opportunity to expand capacity in a highly constrained market, without any other carrier having an equivalent opportunity to do so. This is particularly concerning where another Australian carrier has expressed a clear intention to apply for such capacity, and operate it, should it become available.

6.54 This means that the Commission has been unable to consider the public benefits that may arise from an alternative use of the capacity in question. The Commission does not express a view at this time as to whether such greater benefits would necessarily arise. It would need to receive and compare other proposals as part of a future process in order to reach such a conclusion. However, the possibility that potential public benefits may be foregone because Qantas has not elected to hand back the capacity is a source of concern to the Commission.

6.55 The Commission considers that the current situation could have been avoided if a condition had been attached to the original determinations (as varied) to the effect that, if there was a change in the air services arrangements of the kind occurring in this case, the carrier concerned would have been required to return the capacity immediately for reallocation. The Commission intends, subject to legal advice as to its powers, to review conditions it attaches to similar decisions in future, with the aim of preventing a re-occurrence of the situation that has arisen in this case. The Commission will consult with stakeholders in conducting this review.

7 Role of the ACCC

7.1 The Policy Statement and its associated Explanatory Memorandum make it clear that the ACCC retains primary responsibility for competition policy matters. Nothing in the Commission's decisions should be taken as indicating either approval or disapproval by the ACCC. The Commission's decisions are made without prejudicing, in any way, possible future consideration by the ACCC.

8 Decision ([2001] IASC 210)

8.1 In accordance with section 24(1) of the Act the Commission:

- confirms determinations IASC/DET/9804 and IASC/DET/9910
- requests Qantas to advise, within one month of the date of this decision, whether or not it will resume the own aircraft exercise of its allocated capacity at Osaka and
 - in the event Qantas advises that it will not resume operations at Osaka, the Commission requests that Qantas apply immediately to revoke the determinations in order that the capacity involved can be made available for reallocation; or
 - if Qantas does elect to resume own aircraft services at Osaka, the Commission requires the carrier to do so by no later than the commencement of the Northern Winter 2001 scheduling period.

Dated: 31 May 2001

Ross Jones
Chairman

Michael Lawriwsky
Member

Stephen Lonergan
Member