



INTERNATIONAL AIR SERVICES COMMISSION

DECISION

DECISION: [2002] IASC 212
VARIATION OF: IASC/DET 9810, 2000/107 AND 2001/114
THE ROUTE: SOUTH AFRICA
THE APPLICANT: QANTAS AIRWAYS LIMITED
(ACN 009 661 901)
PUBLIC REGISTER FILES: IASC/APP/200133

1 The application

1.1 Qantas Airways Ltd (Qantas) applied to the Commission on 23 November 2001 to vary IASC Determinations 9618, 9810, 2000/107 and 2001/114 to permit South African Airlines (SAA) to continue code sharing on Qantas operated flights between Australia and South Africa for a further 12 months from 1 July 2002. The Commission authorised code sharing pursuant to these determinations in Decision [2000] IASC 217 of 11 December 2000. Qantas also sought the removal of a condition of the code share approval that requires Qantas and South African Airways to maintain minimum levels of frequency of operation.

1.2 On 10 December 2001, the Commission published a notice inviting submissions from interested parties about the application. A submission was received from the Australian Competition and Consumer Commission (ACCC), dated 18 December 2001. Qantas provided a submission in response to the ACCC's views on 17 January 2002. In response to a request by the Commission for detailed information relating to operations on the South Africa route, detailed confidential information was received from Qantas in a letter dated 26 March 2002.

1.3 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 and SAA each operate four B747 services per week between Australia and South Africa. Qantas operates on a Sydney-Johannesburg routing, with South African Airways flying between Johannesburg and Perth. Both airlines reduced frequency levels from five services per week in early 2002.

2.2 Indirect services between Australia and South Africa are provided by third country carriers, principally Singapore Airlines (via Singapore), Malaysian Airlines (via Kuala Lumpur) and Cathay Pacific (via Hong Kong).

3 Provisions of relevant air services arrangements

3.1 The Australia-South Africa air services arrangements allow designated airlines of the two countries to code share on each other. Qantas does not require the Commission's

approval to code share on SAA's services as the marketing carrier's seats do not involve the use of capacity entitlements.

4 Applicant's proposal

4.1 In reviewing its performance for the 12 months since the code share took effect (in January 2001), Qantas argued that all of the conditions specific to the code sharing authorisation would be met. The conditions were that:

- with effect from 15 January 2001, Qantas operates no fewer than 250 round trip services per annum and SAA operates no fewer than 235 round trip services per annum (excluding supplementary services);
- Qantas and SAA withdraw from all IATA tariff co-ordination activities relating to fare levels between Australia and South Africa; and
- Qantas provide the Commission with a report each quarter setting out the number of seats sold by it on each of SAA's operated services and by SAA on each of Qantas' operated services.

4.2 Qantas advised that it was approaching the Commission earlier than planned because of dramatic changes to international circumstances leading to a downturn in demand for international travel. Amongst other effects, this meant that Qantas could no longer maintain its five weekly services to South Africa. It was reducing to four services per week from 8 February 2002. Qantas had also been advised that SAA was withdrawing one frequency per week from the Johannesburg-Perth route from 9 February 2002. Qantas recognised that a reduction in frequency of this nature meant that a condition requiring at least 250 trips per annum could not be met in future, even with the intention to re-introduce the withdrawn South Africa capacity in December 2002. Whether or not the fifth weekly service would in fact be resumed would be determined by the speed of economic recovery and a revival in travel confidence.

4.3 Accordingly, Qantas argued that it would be appropriate for the Commission to dispense with the requirement for the code share partners to maintain predetermined service levels. Qantas also claimed that there was sufficient evidence available to dispel competition concerns. The airline sought an extension of the code share arrangement for an additional 12 months from the end of the current authorisation (30 June 2002).

Summary of submissions received

4.4 The ACCC reiterated previously expressed concerns about code share arrangements where the code share partners have relatively high market shares and there is limited competition from indirect operators, or there are barriers to entering the market. The ACCC suggested that an assessment of the Qantas application would need to take account of changes in the level of competition from indirect carriers, the prospect of direct competition and movements in fares on the route compared with fares on other similar routes. The analysis should ideally examine the performance of the route before and after the events of September 2001.

4.5 In responding to the ACCC, Qantas argued that extension of the code share would give the code share partners some commercial certainty in difficult circumstances.

4.6 In its further submission of 26 March 2002, responding to the Commission's request, Qantas provided a substantial amount of mostly commercially confidential information relating to the operation of services by Qantas on the South Africa route. The information covered: schedules operated by Qantas and SAA and third country carriers; traffic carried; seat factors; market traffic (including behind and beyond gateways); forward bookings; air fares and sales by fare type; passenger yields; details about comparable routes; route performance; freight carriage and rates; reduction in services; and factors influencing future frequency changes.

5 Commission's assessment

5.1 Pursuant to s. 15(2)(e) of the Act, a carrier cannot use allocated capacity by providing services jointly with any other carrier without the prior approval of the Commission.

5.2 In Decision [2000] IASC 217, the Commission authorised code sharing between Qantas and SAA on the South Africa route. The Commission found that the public benefits associated with allowing the code share were likely to marginally outweigh the detrimental effects that might arise. An important factor in deciding to allow the code share was the Commission's concern that rejection of the application may have a detrimental impact on the level of services between Perth and Johannesburg.

5.3 Given the Commission's concerns that the public benefit outcome would probably be only marginally positive, the Commission imposed conditions designed to enhance public benefits as far as possible. Qantas was required to price and sell its services independently, to not share or pool revenues and to submit to the Commission quarterly reports of the number of code share seats sold by Qantas on SAA's services and vice versa. Further, Qantas and SAA were required to withdraw from IATA tariff co-ordination activities in relation to air fare levels on the route. The approval was also only effective while Qantas and SAA together operated at least 10 services per week on the route. Some flexibility was allowed for the possibility of some reduction in services during periods of low demand – no less than 250 services per annum by Qantas and 235 by SAA.

5.4 The Commission also decided to limit the duration of the code share approval until end June 2002. This was to enable the Commission to review the actual impact of the code sharing, before deciding whether or not to authorise the code share for a further period.

5.5 In assessing whether to grant an extension of the code share authorisation, the Commission now has the benefit of data associated with the operation of services through to the end of January 2002. This data assists the Commission to compare the actual outcomes of the code share with the expected results in its public benefit assessment prior to giving the original approval. It also provides an in-depth insight into the commercial viability of the services on the route for Qantas and, related to that, what might be the operational outcome if the code share was not to continue to be authorised.

5.6 The Commission's assessment is that the code share arrangement is probably, on balance, delivering a level of public benefits consistent with its expectations in approving the code sharing. This conclusion cannot be reached with a great degree of certainty because of the confounding effects of the events of 11 September 2001. Those events led to a sharp drop in demand in the latter part of 2001 and into 2002. This in turn has affected the amount of capacity in the market and the level of air fares. The Commission is satisfied that the reductions in capacity operated by Qantas and SAA were largely induced by the sharp decline in demand, rather than solely as a means of reducing costs and driving up load factors. Other indirect operators to South Africa have also reduced capacity in response to lower demand.

5.7 While Sydney services appear to be commercially successful, it seems that the Perth services are performing significantly less well. One of the key reasons the Commission authorised the code share initially was because it was concerned that the level of Perth services may have otherwise been placed at risk. The weak demand in the wake of September 11 has contributed to reducing the profitability of the South Africa services. Cost savings arising from service restructuring with implementation of the code share have no doubt helped to offset this and assisted the airlines to maintain Perth services in particular.

5.8 The Commission considers that, in light of current market circumstances, it is appropriate to reduce the minimum frequency requirements from the levels currently imposed on the carriers as a condition of continued approval of the code share. The Commission notes that the two carriers are together operating a total of eight weekly services between Australia and South Africa, following recent reductions in frequency by both Qantas and SAA. The Commission will make it a condition of continued approval of code sharing that the carriers between them maintain at least this level of frequency, but will allow short term reductions if necessary because of seasonal demand changes or for unforeseen operational reasons. The Commission's intention in maintaining a minimum frequency condition is to endeavour to ensure a continuation of services to both Perth and Sydney. The Commission is hopeful that the carriers will in fact schedule additional services as market demand recovers and in line with seasonal variations which are fairly pronounced on the South Africa route.

5.9 The Commission's other main concern is about prices facing business travellers. Qantas and SAA, as the only direct carriers, have a substantial advantage over indirect carriers because of the much shorter travel times of the direct services. Indirect carriers cannot offer a comparable product to the direct carriers and can only endeavour to compete by offering lower fares. This situation prevailed prior to the code share commencing. The Commission cannot judge to what extent the code share has affected competition on price between Qantas and SAA for the business market, although there is evidence available to the Commission that they are pricing fares differently.

Conclusion

5.10 The Commission concludes that the net public benefits offered by the code share arrangements have proved to be marginally positive.

5.11 The Commission will authorise a further extension of code sharing, until 30 June 2003, and will again review the situation in advance of expiry of that authorisation. Determinations 9810, 2000/107 and 2001/114 will be amended accordingly. Determination 9618, which expires on 30 June 2002 will be renewed by the Commission (see separate determination) and the conditions associated with the code share will be incorporated directly into the fresh determination.

5.12 Qantas has argued that maintenance of the code share is important in ensuring that services are maintained. The Commission accepts that the primary risk associated with not authorising the code share would be the potential for loss of services to Perth. If Perth services were reduced or withdrawn, there would be a serious erosion of public benefit. Accordingly, the Commission considers it reasonable to attach a condition of approval requiring the airlines to maintain a certain minimum level of services. However, reflecting the weakness in traffic in international markets, as noted above the Commission will reduce to eight the number of services per week Qantas and SAA will be required to maintain between them. Previously the requirement was that ten services per week must be maintained. The revised level is consistent with the reduced number of services the two carriers are now operating. Short term flexibility will be allowed in the event of seasonal demand fluctuations or if there are unforeseen operational issues. The airlines will not be permitted to reduce frequency on a longer term basis without first notifying the Commission.

6 Role of the ACCC

6.1 The Minister's 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 of code share operations by the ACCC.

7 Decision ([2002] IASC 212)

7.1 In accordance with section 24(1) of the Act, the Commission varies Determinations 9810, 2000/107 and 2001/114 to permit SAA to code share on Qantas flights operated to and from South Africa until 30 June 2003, consistent with the Qantas/SAA code share and commercial agreements provided to the Commission, subject to the following conditions:

- any amendments to the code share agreement (including to Annex 1), or to the commercial agreement in so far as it affects the former, must be approved by the Commission;
- any new code share agreement or commercial agreement in so far as it affects the former must be approved by the Commission;
- Qantas must price and sell its services on the route independently;
- Qantas must not share or pool revenues under any such agreement;

- Qantas must take all reasonable steps to ensure that all passengers are informed, at the time of ticket reservation, of the carrier actually operating the flight;
- the approval will only be effective while Qantas and SAA together operate at least eight services per week on the South Africa route, although the Commission will allow reductions from this level during periods of low demand or for unforeseen operational reasons, provided there is prior notification to the Commission;
- Qantas and SAA withdraw from all IATA tariff coordination activities in relation to air fare levels between Australia and South Africa; and
- Qantas must submit to the Commission reports each quarter on the number of code share seats sold by it on each of SAA's operated services and by SAA on each of Qantas' operated services.

Dated: 22 April 2002

Ross Jones
Chairman

Michael Lawriwsky
Member

Stephen Lonergan
Member