



INTERNATIONAL AIR SERVICES COMMISSION

DECISION

DECISION NO: [2002] IASC 218
VARIATION OF: [2001] IASC 107, [2001] IASC 116,
[2002] IASC 104 AND [2002] IASC 108
THE ROUTE: JAPAN
THE APPLICANT: QANTAS AIRWAYS LIMITED
(ACN 009 661 901) (QANTAS)
PUBLIC REGISTER FILE: IASC/APP/200213

1 The application

1 Qantas applied to the Commission on 9 May 2002 to vary four determinations allocating its capacity on the Japan route. Qantas sought approval for Japan Airlines to code share on new daily Qantas' B767-300 services between Melbourne and Tokyo. The services are due to commence on 1 July 2002, with code sharing requested to commence on a date to be determined but no later than 1 August 2002.

1.1 The Commission published a notice on 15 May 2002 inviting submissions about the application. Submissions were received from the Australian Competition and Consumer Commission (ACCC) on 21 May 2002, the Australian Tourist Commission on 24 May 2002 and the Oceanis Australia Group on 30 May 2002. A second submission was received from Qantas on 24 May 2002. This responded to the matters raised in the ACCC submission.

1.2 All material supplied by the applicant and other submitters is filed on the Register of Public Documents.

2 Provisions of relevant air services arrangements

2.1 The Australia – Japan air services arrangements permit code sharing between the designated airlines of Australia and Japan. Where the designated airlines code share, capacity is counted as being exercised only by the operating carrier. Qantas is the operating carrier in this case and, as such, requires the Commission's approval for Japan Airlines to code share on its services.

3 Summary of submissions received

Qantas

3.1 Qantas is introducing daily B767-300 services between Melbourne and Tokyo from 1 July 2002. Three of the seven services will operate via Sydney on the northbound leg, with all southbound services operating non-stop to Melbourne. Qantas is exercising

capacity available to it under four determinations. Together these provide the 8.4 units of B767-200 equivalent capacity per week required to support the daily services.

3.2 Qantas advised that Japan Airlines has indicated it wishes to code share on the Qantas services, thereby adding Melbourne as an Australian destination. Japan Airlines does not itself operate services to Melbourne.

3.3 Qantas has not yet concluded a formal code share agreement with Japan Airlines. However, the proposal outlined by Qantas is that the code share seats available to Japan Airlines would comprise a “hard” block of 30 seats per flight, with an optional “soft” block of a further 23 seats per flight. The hard block constitutes about 13% of available aircraft seating. The addition of the soft block makes the proportion of available seats about 23%. Hand-back provisions would apply to the soft block – 30 days and seven days for economy and business class respectively. Qantas could sell any seats returned by Japan Airlines from the soft block. The code sharing would be limited to the Melbourne-Tokyo and vv sector.

3.4 Qantas argued that its application should be considered against the general criteria for assessing benefit to the public in paragraph 4 of the Minister’s Policy Statement. However, Qantas described what it considered to be the public benefits that would arise from the new services and the associated code share arrangement. In prefacing this, Qantas noted that a recent Tourism Forecasting Council report stated that Japan’s economic outlook was likely to result in reduced visitor number to Australia in the short to medium term (falls of 5% and 3.9% for 2002 and 2003 respectively). The longer term forecast was for average growth of one percent per annum for 2004-2012. Qantas noted that a new daily Melbourne-Tokyo service represented a large increase in capacity in these difficult market circumstances. Qantas argued that Japan Airlines participation in the services, through purchase of seats, would improve the financial position of the flights, which otherwise would make a loss in their initial years.

3.5 In addressing public benefits, Qantas argued that the non-stop Melbourne-Tokyo services would boost tourism in Victoria. Currently, most Japanese visitors to Melbourne arrive via Sydney. Qantas will provide connections to Adelaide, Hobart and New Zealand. Melbourne-based passengers will benefit from reduced travel times and southern Australian exporters will have improved capacity and frequency of service. Fresh produce exports, particularly seafood from Tasmania, are likely to grow.

3.6 Qantas also argued that Japan Airline’s code share presence would raise awareness of Japanese travel agents and consumers about the services. Japan Airlines would add a competitive sales and marketing force on the route.

Australian Tourist Commission (ATC)

3.7 The ATC strongly supported the code share proposal being approved. It argued that the participation by Japan Airlines would assist in making the route more profitable and contribute towards the broader goal of sustainable air services between Australia and Japan. The ATC also pointed out that it would be supporting the services through its own marketing efforts.

Australian Competition and Consumer Commission (ACCC)

3.8 The ACCC submission reiterated concerns it expressed in its 26 March 2002 submission in relation to another code sharing proposal between Qantas and Japan Airlines on the Cairns and Brisbane routes and generally. Those concerns were that the arrangement raised competition issues, being between the two dominate operators on a high volume route, with little indirect competition and little likelihood of new entrants. The ACCC considered that the code share proposal in relation to Melbourne reinforced those concerns.

3.9 The ACCC indicated that approval of the arrangement would mean Qantas and Japan Airlines code shared on nearly 70% of the flights they operate between Australia and Japan. Services to and from Perth and Sydney would be the only ones on which there was no code sharing. The ACCC expressed the view that it would be unlikely that Japan Airlines would serve Melbourne in its own right if the code share arrangement proceeded. The ACCC did not accept that the wish of Japan Airlines to expand its route network can be justification for approving the code share. It said that accepting such an argument would provide a precedent for similar arrangements on other on similar routes, such as between Qantas and Cathay Pacific on the Hong Kong route.

Qantas (second submission)

3.10 In responding to the ACCC submission, Qantas argued that the participation of Japan Airlines would in fact increase destination competition. With Japan Airlines adding Melbourne to its network, it would compete with Qantas on the Melbourne – Tokyo route. Otherwise, Qantas would be the sole marketer and seller. Qantas pointed to the power of Japan Airlines' distribution channels in promoting Melbourne in the Japanese market, thus raising the competitiveness of Melbourne as an international destination.

3.11 Qantas argued that Japan Airlines has not operated to Melbourne, despite having the opportunity to do so since 1985, even when traffic growth rates were high. This reflected Japan Airlines' assessment of the viability of the route. Qantas says it is almost inconceivable that disallowing the code share would encourage Japan Airlines to commence its own non-stop flights to Melbourne, particularly given the current market circumstances.

3.12 If Japan Airlines was not authorised to code share, its passengers wishing to travel to Melbourne would have to travel to Sydney and connect with domestic flights to Melbourne.

3.13 Qantas concluded by stating that, if the services do not prove viable, it would be forced to consider moving the capacity to an alternative Australian point.

Oceanis Australia Group

3.14 The Oceanis Australia submission was also on behalf of the Victorian Employers' Chamber of Commerce and Industry. It urged the Commission to support the Qantas application. It argued that the recommencement of non-stop services between Tokyo and Melbourne is a significant strategic development for Melbourne and Victoria and would result in a greater profile for Victoria in the Japanese market.

4 Commission's consideration

4.1 The Commission considered applying the paragraph 5 public benefit criteria in the Minister's Policy Statement to assess the Qantas application. The proposal represents an expansion of Qantas' code share arrangements with Japan Airlines to a new route in the Australia – Japan market. The Commission has regularly expressed its concern at code sharing in the Australia – Japan market where Qantas and Japan Airlines are now the only direct operators and there is limited competition from third country carriers.

4.2 After careful consideration, the Commission has decided not to apply the paragraph 5 criteria in this case. The Commission considers that there is little prospect of Japan Airlines introducing direct services to Melbourne in its own right. The opportunity to do so has been available to Japan Airlines for many years and has not been taken up. The weak outlook for the Australia - Japan market suggests that the Melbourne route is unlikely to improve in its commercial attractiveness relative to other international routes available to Japan Airlines in the foreseeable future. In these circumstances, the introduction of a code share arrangement between Qantas and Japan Airlines between Melbourne and Tokyo is unlikely to be detrimental to competition on the route. To the extent that there are hard block seats involved in the code share arrangement, there may be a small degree of incentive for the airlines to compete with each other for market share, at least until a commercially viable level of traffic was established for both parties.

4.3 The arrangement may be beneficial to Qantas in assisting the establishment and viability of Qantas' services, through the seat purchase arrangement and whatever marketing effort Japan Airlines makes to support sales of its seats. If this contributes to the services becoming viable in the longer term, this should be beneficial to the Australian tourism and export industries. The Commission notes the strong support of the Australian Tourist Commission. The ATC has indicated that it would back the services through its own promotional efforts.

4.4 In terms of possible competition from third-country carriers, the Commission notes that Singapore Airlines operates double daily services between Melbourne and Singapore with connections to Tokyo. Travel times on those services (either about 16 or 18 hours depending on the particular flight) are comparable with existing Qantas services via Sydney (16.5 hours). However, the new direct Qantas services will reduce travel time for Melbourne – Tokyo passengers by over six hours (except for the three northbound services which continue to operate via Sydney). This is a substantial benefit to consumers and will give Qantas a competitive advantage over Singapore Airlines, particularly for the time-sensitive business market and for the export of fresh produce.

4.5 The Commission notes that the code share arrangement is not proposed to apply to the Sydney-Tokyo leg of the three weekly northbound services. Sydney-Tokyo is a major route on which Qantas and Japan Airlines are established direct competitors and it is difficult for the Commission to foresee circumstances where code sharing on this route would be anything but anti-competitive with little public benefit.

4.6 In relation to the specifics of the proposed seat purchase arrangement, as noted above, a relatively small number of seats is involved. The Commission would have preferred to see the arrangement involve a hard block of seats only, rather than the dual

hard/soft arrangement proposed. However, as the soft block constitutes only a little over 20 seats per flight, the Commission will not object to this part of the arrangement. The Commission would prefer that any future expansion by Japan Airlines at Melbourne would be in the form of own-operated services, rather than through an expansion of code sharing. In view of this preference, the Commission would be likely to look critically at any future proposal by Qantas to expand the number of seats involved in the code share arrangement..

4.7 In its recent Determination [2002] IASC 108, the Commission limited the duration of its approval of the arrangement between Qantas and Japan Airlines to June 2004, during which it will monitor Qantas' sales and yield performance. The Commission will do the same in this case. By mid-2004, the Commission should have sufficient information to assess whether or not continued code sharing by Japan Airlines would be necessary for the ongoing viability of the Qantas services and for the development of traffic between Melbourne and Tokyo.

5 Conclusion

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

5.2 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. The Commission will vary the determinations as requested to enable code sharing, on the condition that a signed copy of the finalised Qantas/Japan Airlines code share agreement is provided to the Commission and approved by it, before code sharing commences. As indicated above, the Commission will limit the duration of the approval to end June 2004.

6 Decision [2002] IASC 218

6.1 In accordance with section 24 of the Act, the Commission varies Determinations [2001] IASC 107, [2001] IASC 116, [2002] IASC 104 and [2002] IASC 108 ,as requested by Qantas, by *adding* the following conditions:

- Qantas may use the capacity to provide services jointly with Japan Airlines until end June 2004 in accordance with:
 - the codeshare agreement, signed by Qantas and Japan Airlines, being approved by the Commission, with such additional conditions (if any) as the Commission may require, prior to code share services commencing, or as varied except in relation to:

- the number of seats to be purchased exceeding 371 per week in each direction; or
 - Melbourne – Tokyo being the city pair served; or
 - any financial adjustment;
- variations to the codeshare agreement which relate to any of the excepted matters referred to above, subject to the prior approval of the Commission; or
 - any subsequent code share agreement between Qantas and Japan Airlines for operations on the Australia - Japan route, whether or not it replaces the existing agreement, with the prior approval of the Commission;
- under the code share agreement with Japan Airlines:
 - Qantas must price and sell its services on the route independently of Japan Airlines;
 - Qantas must not share or pool revenues under any such agreement; and
 - Qantas must take all reasonable steps to ensure that passengers are informed of the carrier actually operating the flight at the time of booking
 - Qantas must submit to the Commission reports each quarter on the number of code share seats sold by Japan Airlines on Qantas' operated services between Melbourne and Tokyo, for both the hard and soft block seats; and its yields per revenue passenger kilometre for all passenger classes on these services.

Dated: 31 May 2002

Ross Jones
Chairman

Michael Lawriwsky
Member

Stephen Lonergan
Member