



Australian Government

International Air Services Commission

DETERMINATION

Determination: [2004] IASC 103
The Route: Hong Kong
The Applicant: Qantas Airways Limited (Qantas)
(ACN 009 661 901)
Public Register: IASC/APP/200409

1 The application

1.1 On 18 May 2004, Qantas applied for an allocation of seven services per week beyond Hong Kong to the United Kingdom under the Australia – Hong Kong air services arrangements. Qantas plans to commence operating three B747-400 services per week between Sydney and London via Hong Kong with effect from November 2004. The airline intends to increase its flying to four services per week in November 2005, and to expand to daily operations beyond Hong Kong from April 2006. Qantas sought authorisation for British Airways to code share on the services under the existing code share agreement between the two carriers on the same terms as the Commission has authorised in previous cases. Qantas advised that it has the landing slots at London's Heathrow airport necessary to operate the proposed services.

1.2 On 24 May 2004, the Commission published a notice inviting applications for some or all of the capacity sought by Qantas. No applications were received.

1.3 All material supplied by the applicant is filed on the Commission's Register of Public Documents

2 Provisions of relevant air services arrangements

2.1 Operation of the capacity involved in the application is consistent with the provisions of the Australia - Hong Kong and Australia – United Kingdom air services arrangements. According to the Register of Available Capacity there are seven services per week available for flights beyond Hong Kong to the United Kingdom, with four services available for immediate operation and a further three able to be operated only from the commencement of the Northern Summer 2006 scheduling period. The Hong Kong arrangements permit code sharing between Australian carriers and third country carriers, consistent with traffic rights available to those third country carriers.

3 Commission's consideration

3.1 Under paragraph 6.2 of the Minister's policy statement, in the circumstances of this case (there is only one applicant for allocation of capacity on the route) only the criteria in paragraph 4 of the policy statement are applicable. Under paragraph 4, the use of Australian entitlements by a carrier that is reasonably capable of obtaining the necessary approvals and of implementing its application is of benefit to the public.

3.2 The Commission notes that Qantas has indicated that it already has sufficient capacity allocated to it on the UK route to operate all seven of the beyond Hong Kong services, although this would have required some reorganisation of existing schedules if the airline had not been able to obtain any further UK capacity. Qantas had separately sought the three services per week of capacity remaining unallocated on the UK route and this capacity was also applied for by Backpackers Xpress. Subsequently, in Determination [2004] IASC 112, the Commission allocated all three remaining services on the UK route to Qantas.

3.3 The Commission finds that Qantas is reasonably capable of obtaining the necessary approvals to operate on the Hong Kong route as proposed and of implementing its application. Accordingly, the Commission concludes that Qantas meets the paragraph 4 requirements and therefore that the use of the entitlements by Qantas would be of benefit to the public. In accordance with section 7(1) of the *International Air Services Commission Act 1992* (the Act), the Commission may make a determination allocating the available capacity sought by Qantas. The Commission would ordinarily make such a determination without further consideration. However, the circumstances of this case have raised some broader issues for the Commission, which it discussed in its Draft Determination [2004] IASC 103 of 9 July 2004 proposing to allocate to Qantas seven services per week in each direction beyond Hong Kong. Submissions in response to the draft determination were invited and a submission was received from Qantas. The concerns raised by the Commission in its draft determination, the Qantas submission, and the Commission's response to the Qantas submission are discussed as follows.

3.4 The Commission understands that rights for Australian carriers to operate beyond Hong Kong to the UK have only recently been secured under the bilateral arrangements, after years of negotiation, as Qantas has noted in its submission. Given the difficult history in securing rights on this sector, the Commission is concerned at the implications for the scope for future competition on the route if there is no further expansion of the limited beyond-Hong Kong bilateral opportunities for a long period, as seems likely, and Qantas is allocated all seven services now, three of which cannot be operated for nearly two years. Such an outcome would have the effect of precluding any other prospective Australian carrier from having the opportunity of operating in this important market for the foreseeable future. Any other Australian carrier operating to Hong Kong in the future would be obliged to terminate services there and could not compete directly with Qantas or foreign carriers for traffic on the Australia – UK route over Hong Kong, or for Hong Kong – UK traffic.

3.5 This situation contrasts with that pertaining to other important Asian intermediate points, such as Singapore and Bangkok. In these cases, there are extensive capacity entitlements under air services arrangements for operations beyond these points to the UK. However, the Commission notes that capacity on the UK route is fully allocated (see

[2004] IASC 112), but understands that the Department of Transport and Regional Services is endeavouring to schedule air services negotiations with the UK authorities. Until the UK capacity situation is resolved, no other Australian carrier could compete with Qantas on the UK route, irrespective of the situation under air services arrangements with intermediate countries.

3.6 Legal advice obtained by the Commission indicates that it is within the scope of its powers under the Act to not allocate capacity in circumstances where the Commission has otherwise found there to be a public benefit associated with the allocation of the capacity. The Commission considers that it has this discretion under section 7(1) of the Act, provided the Commission considers that there are sufficiently important considerations which would justify such a course of action. In this case, the Commission considers that there is at least a possibility that benefits might ultimately be maximised through the temporary withholding of some of the capacity (that capacity which cannot be operated until April 2006), and its allocation nearer to the time when it could actually be operated, either to Qantas (if it applies), or to another applicant who may apply for that capacity at a later time. If no such other applicant emerged, or did but the Qantas proposal was found to deliver greater public benefits, there would have been no lessening of public benefit through the temporary withholding of the allocation of such capacity, as Qantas would not be capable of implementing the latter part of its application until late March 2006 and no public benefits could arise prior to that time. The Commission considers that such a consideration is within the scope and purpose of the Act, noting that the object of the Act is to enhance the welfare of Australians by promoting economic efficiency through competition in the provision of international air services.

3.7 In this regard, the Commission notes paragraph 3.2 of the Minister's policy statement which states that: "The Commission should, in any adjudication of applications for capacity allocation, seek to *maximise the benefits to the public to be gained from the operation of the capacity*, assessed in accordance with the Act and against applicable criteria set out in this policy statement." (italics added). In this case, there is only one application, so the Commission is not able to compare benefits that might arise from an alternative proposal for the use of the capacity.

3.8 Qantas has argued in its submission that paragraph 3.2 is only applicable to competing applications where there is a need for the Commission to adjudicate. More broadly, Qantas considers that there is no reference or provision in the Act or policy statement for capacity not subject to competing applications to be withheld from competent applicants. Qantas says there is no suggestion, express or implied, that some capacity could be withheld in case a second applicant emerges in future. Qantas also points to the recommendations of the Productivity Commission review and the Government's position on those recommendations, particularly that where an application is uncontested, the allocation of that capacity should be approved automatically.

3.9 The Commission observes that, whatever may have been the Government's intentions at the time (five years ago) in responding to the recommendations of the Productivity Commission, the Commission is required to administer the Act and policy statement as they were amended, by the Parliament and the Minister respectively, some years after the recommendations were made. Having again had regard to the legal advice available to the Commission in relation to the Act and policy statement as they now stand

and Qantas' views, the Commission continues to consider that its interpretation of its powers and responsibilities under the legislative framework is sound.

3.10 Taking all of these considerations into account, as suggested above the Commission has assessed the possibility of allocating only four services to Qantas at this time, and not allocating the three services which are not permitted to be operated until late March 2006. This approach would give Qantas commercial certainty to operate the services it proposes to implement through to November 2005. However, it would mean the carrier would need to reapply at a later time for the remaining capacity, unless another carrier had already applied for the remaining capacity prior to a new application from Qantas, in which case Qantas could lodge a competing application.

3.11 If a partial allocation was to be made now, there would be the possibility that Qantas might not ultimately obtain all seven services. The Commission has therefore considered whether the operation of less than the full seven services per week would not be commercially worthwhile over the longer term. If so, there could not be greater benefit associated with the capacity being split between two Australian carriers compared with it being allocated to a single carrier. Qantas argued in its response to the draft determination that it would have preferred to operate a daily service from the outset, but that this was not possible because of the phased rights available under the air services arrangements. Qantas also argued that it believes the ability to offer daily services on the Hong Kong – UK route is necessary for Qantas to compete effectively with foreign carriers, including Virgin Atlantic which has announced plans to enter this route with daily services as part of a through service to Australia.

3.12 The Commission accepts the Qantas proposition that a daily service would represent a desirable level of operation on this route from a single carrier commercial viewpoint. However, it infers from the fact that Qantas has sought to commence services with three services per week, nearly two years before it would be possible to operate a daily frequency, that three services per week represents a commercially sustainable level of operations for this route. Indeed, Qantas could have proposed to operate from the outset the available fourth weekly frequency but has sought to defer for up to a further year the operation of this frequency. Had Qantas considered that only a daily service was commercially sustainable, it could have proposed not to implement any flights until it could commence a daily service from the time when all seven services were available for operation.

3.13 However, in considering whether to withhold any capacity from Qantas, the Commission needs to consider whether there is a realistic possibility that another Australian carrier might seek to enter the Hong Kong – UK route in the relatively near future. On the anecdotal facts known to the Commission, it is unlikely that this would occur. The Commission notes that no prospective Australian carrier made a submission in response to the draft determination.

3.14 After taking all relevant factors into account, the Commission will allocate to Qantas all of the seven services per week of capacity sought. The Commission considered the possibility of making an interim (three year) allocation to Qantas for this capacity, as at the renewal stage any new applicants for the capacity could compete for it on public benefit criteria which did not favour the incumbent. However, the Commission is aware that to do so would mean that the final three of the total of seven services could be used in practice

for only a little over a year before the end of the period of the determination. This short duration would not enable Qantas to obtain a reasonable return on the capital invested in providing the final three services, before the capacity was again open to contest under the provisions of the Minister's policy statement applicable to the renewal of interim determinations.

3.15 The Commission will therefore allocate the capacity for a period of five years. It notes, however, that this will confer on Qantas the benefits of incumbency set out in the Minister's policy statement. The criteria applying to the renewal of full five year determinations reflect a presumption in favour of the carrier seeking renewal, in circumstances where the start-up phase on the route in question is over. In the Commission's view, the start-up phase on the Hong Kong route has concluded, as Ansett International has previously been allocated sufficient capacity to develop efficient and commercially sustainable operations on the route. This leaves very limited grounds on which another applicant might seek to rebut the presumption in favour of Qantas at the renewal stage. With little current likelihood that bilateral opportunities beyond Hong Kong to the UK will be expanded, there is small prospect of another Australian carrier operating between Australia and the UK via Hong Kong.

3.16 The Commission agrees with Qantas that the policy statement says that the Commission should specify as short a period for the use of capacity as is reasonable having regard to the steps necessary to commence operations. In this regard, the Commission queries whether it should allow Qantas to hold the fourth allocated frequency unused until November 2005 as it has requested. The Commission has little doubt that Qantas could implement this service earlier if required to do so by the Commission. However, the Commission will provide the commercial discretion which Qantas has sought, as there has been no other applicant which might have sought to use the capacity sooner, nor is there likely to be in the near future.

3.17 Qantas rightly points out that the final three services of capacity cannot be used until April 2006, so no other carrier could use the capacity prior to that time in any case. The Commission's argument is that Qantas' desire to have commercial certainty about the allocation of these services, by seeking an allocation so far from when they can be operated, should be balanced against the potential interests of other carriers which might emerge to seek the capacity in the next year or so.

3.18 The Commission would not wish to see a situation develop whereby an established carrier engaged in a process of obtaining and effectively warehousing capacity across different routes, by arguing that it needed to secure capacity well ahead of when it can or is to be used, in order to give it commercial certainty. Such a process would preclude scope for future new entry by carriers which may not have immediate operating plans or the capability to operate the services now (and therefore may not be able to compete successfully for the capacity now) but which may be in a position to seek the capacity in a year or two. Such warehousing would not be consistent with the principles of the Act and policy statement.

3.19 Under Section 15(2)(e) of the Act, the Commission must include a condition in determinations stating the extent to which the carrier may use that capacity in joint services with another carrier. The Commission will authorise the use of the capacity in joint services with British Airways on terms consistent with those in the other determinations allocating

capacity to Qantas in which the operation of joint services between the two carriers is authorised.

4 Determination allocating capacity on the Hong Kong route to Qantas ([2004] IASC 103)

4.1 The Commission makes a determination in favour of Qantas, allocating seven services per week in each direction beyond Hong Kong under the Australia - Hong Kong air services arrangements.

4.2 The determination is for five years from the date of this determination.

4.3 The determination is subject to the following conditions:

- Qantas, or another Australian carrier which is a wholly owned subsidiary of Qantas, is required to:
 - operate a minimum of three services per week from no later than 1 November 2004;
 - operate four services per week from no later than 1 November 2005;
 - fully utilise the capacity from no later than the commencement of the Northern Summer 2006 scheduling period, or from such other date approved by the Commission;
- the capacity may be used by Qantas to provide services jointly with British Airways in accordance with:
 - the code share agreement dated 5 October 1997; or
 - any new code share agreement, whether or not it replaces the existing agreement, with the prior approval of the Commission;
- under the arrangements with British Airways, Qantas may only price and market its services, or share or pool revenues/profits on the route, jointly with British Airways as long as such practices are authorised under the *Trade Practices Act 1974* or otherwise authorised by the Australian Competition Tribunal, in the event of review by that Tribunal;
- to the extent that the capacity is used to provide joint services on the route, Qantas must take all reasonable steps to ensure that passengers are informed of the carrier actually operating the flight at the time of booking;
- changes in relation to the ownership and control of Qantas are permitted except to the extent that any change:
 - results in the designation of the airline as an Australian carrier under the Australia - Hong Kong air services arrangements being withdrawn; or

- has the effect that another Australian carrier, or a person (or group of persons) having substantial ownership or effective control of another Australian carrier, would take substantial ownership of Qantas or be in a position to exercise effective control of Qantas, without the prior consent of the Commission, and
- changes in relation to the management, status or location of operations and Head Office of Qantas are permitted except to the extent that any change would result in the airline ceasing to be an airline designated by the Australian Government for the purposes of the Australia – Hong Kong air services arrangements.

Dated: 30 July 2004

John Martin
Chairman

Stephen Lonergan
Member

Michael Lawriwsky
Member