



Australian Government

International Air Services Commission

DECISION

Decision:	[2008] IASC 215
Variation of:	[2006] IASC 117
The route:	Japan
The applicant:	Qantas Airways Limited (ACN 009 661 901) (Qantas)
Public Register:	IASC/APP/200818

1 The application

1.1 Qantas applied to the Commission on 12 August 2008 for a variation of Determination [2006] IASC 117 to enable code sharing by Japan Airlines on daily Jetstar services between Tokyo and Cairns from 18 December 2008. Jetstar will replace Qantas' twice daily services on the sector from this date. Qantas advised that the proposed code share would be governed by an amendment to the current free sale code share agreement between Jetstar and Japan Airlines. A more detailed summary of the application is set out below.

1.2 The Commission published a notice on 18 August 2008 inviting submissions about the application. A submission was received on 1 September 2008 from Tourism Queensland supporting the Qantas application. Public material supplied by the applicant and submissions are filed on the Register of Public Documents. Confidential data supplied by Qantas as a condition of approval of the code share arrangements is filed on the Commission's Confidential Register.

2 Traffic Levels

2.1 The table below summarises traffic levels on the Japan route for the year ending June 2008, compared with the previous year. It shows that total traffic fell by over eight percent, year on year. However, there are markedly different trends in traffic growth between the Australian resident and Japanese visitor segments of the market. While the resident market has been rising, the larger visitor component has been falling steadily for some years.

2.2 Visitor numbers in the year to June 2008 declined by nearly 15%. There were about 181,000 fewer Japanese visitors to Australia than in the previous twelve months period. By contrast, the number of Australian resident travellers to Japan in the year ending June 2008 increased by 57,000 over the year before. The result of these opposing trends changes is that Australian resident travel now makes up over 21% of traffic on the route, compared with less than 16% just one year previously.

AUSTRALIA - JAPAN

MONTHLY OD TRAFFIC SUMMARY

LATEST YEAR ENDING DATA	JUN 2007	JUN 2008	PAX EWEW or OW	%
	PAX	PAX		CHG
TOTAL OD TRAFFIC	1,470,061	1,345,992	12,942 EWEW	-8.4%
TOTAL VISITORS (ARR & DEP)	1,237,566	1,056,506	10,159 EWEW	-14.6%
(Proportion of Total OD Traffic)	(84.2%)	(78.5%)		
TOTAL RESIDENTS (ARR & DEP)	232,492	289,492	2,784 EWEW	24.5%
(Proportion of Total OD Traffic)	(15.8%)	(21.5%)		
TOTAL ARRIVALS (VIS & RES)	732,430	671,499	12,913 OW	-8.3%
TOTAL DEPARTURES (VIS & RES)	737,631	674,493	12,971 OW	-8.6%
TOTAL VISITOR ARRIVALS	618,594	527,983	10,154 OW	-14.6%
TOTAL RESIDENT DEPARTURES	118,658	145,974	2,807 OW	23.0%
SHORT TERM VISITOR ARRIVALS	609,302	518,932	9,979 OW	-14.8%
SHORT TERM RESIDENT DEPARTURES	114,453	141,958	2,730 OW	24.0%

Source: Australian Bureau of Statistics

3 Provisions of the relevant air services arrangements

3.1 The air services arrangements between Australia and Japan allow code sharing between the designated airlines of Australia and Japan. Under these arrangements, where the designated airlines code share with each other, capacity is counted as being exercised only by the operating carrier. As a consequence, the Commission's approval is required for Japan Airlines to code share on Jetstar's flights, as Jetstar will be the operating carrier under this proposal. Commission approval is not needed for Qantas, as the marketing carrier, to code share on services operated by the Japan Airlines group.

4 Summary of application

4.1 Qantas advised that it would cease its twice daily operations on the Cairns-Tokyo sector on 17 December 2008. From 18 December 2008, Qantas' services on this sector will be replaced by a daily service operated by Jetstar.

4.2 Jetstar will also operate on the Gold Coast – Tokyo sector five days a week from 18 December 2008. This is a new sector for the Qantas group. Jetstar will not code share with Japan Airlines on this sector.

4.3 Japan Airlines has informed Qantas that it would like to code share with Jetstar on the Cairns–Tokyo sector. Jetstar has not operated to Tokyo before, and Qantas believes that the viability of these new services will be strengthened by the marketing presence of Japan Airlines and its links into the travel distribution chain in Japan.

4.4 Qantas drew the Commission's attention to the effects of the increase in fuel prices and the continuing weakness of the Japan route. Qantas has advised that these effects, combined with the global economic slowdown have resulted in Qantas making a number of changes to its structure and operations. Qantas also advised that under-performing routes will be under greater pressure than ever.

4.5 Qantas also requested the removal of conditions relating to its code share agreement with Japan Airlines that are no longer relevant. Qantas further sought permission for code sharing between Qantas and any wholly owned Qantas subsidiary.

5 Summary of submission received

5.1 Tourism Queensland supported approval of the code share arrangements between Jetstar and Japan Airlines. Although the number of Japanese visitors to Queensland had declined in recent years, Japan remained the single largest international source market to Cairns and the Gold Coast. In the year ended March 2008, there were 328,000 Japanese visitors to Queensland, which attracts almost two of every three Japanese tourists to Australia. This generates an estimated \$479 million in direct visitor expenditure and supports about 4,600 tourism jobs in Queensland. Japan is also an important export market for Queensland, with much of the market made up of time sensitive perishable products which depend on regular air services.

5.2 In Tourism Queensland's view, stand alone Jetstar's services are sustainable only through co-operative arrangements with the incumbent carriers in the Australia – Japan market. In particular, the proposed arrangement provides access to Japan Airlines' distribution system. The code share arrangement would facilitate a smooth transition from Qantas to Jetstar's services and sustain strong Japanese visitor numbers.

6 Commission's consideration

6.1 When considering applications to vary determinations, the Commission must decide whether the determinations, as varied, would be of benefit to the public. Under section 6.3 of the Minister's policy statement, where a carrier requests a variation of a determination to allow it flexibility in operating its capacity and no submission is received about the application, only the criteria in paragraph 4 of the policy statement are applicable. Under paragraph 4, the use of entitlements by an Australian carrier that is

reasonably capable of obtaining the necessary approvals and of implementing its proposals is of benefit to the public.

6.2 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 Minister's policy statement indicates that the Commission would generally be expected to authorise code sharing but where it has serious competition concerns about a particular proposal is able to subject it to detailed consideration against the public benefit criteria contained in paragraph 5 of the policy statement.

6.3 The Commission has consistently subjected to careful scrutiny applications for code sharing between Australian and Japanese carriers on the Japan route. This is because of concerns about the potential impact of such arrangements on competition in this large market. The scope for code sharing to reduce competition has increased since 2001, when the Qantas-group airlines and Japan Airlines-group airlines have been the only direct operators on the route and seek to code share with each other.

6.4 Most recently, in June 2008, the Commission reviewed code sharing by Japan Airlines on Qantas' services between Tokyo and Cairns and between Tokyo and Melbourne.

6.5 In that review, the Commission noted the ongoing weakness in Japanese visitor demand for travel to Australia. While partially offset by growing numbers of Australian residents flying to Japan, the overall traffic trend continued a downward decline that has persisted for some years. The Commission also took account of Qantas' announcement that it would withdraw its Tokyo – Melbourne services from September 2008 and end its Cairns – Tokyo services from 17 December 2008, with Jetstar taking over flying on the Cairns – Tokyo sector from that time. In light of these circumstances, the Commission authorised a continuation of code sharing on the Cairns and Melbourne to Tokyo services to the end of 2008, without subjecting the application to the detailed paragraph 5 criteria of the Minister's policy statement. As anticipated, Qantas has now applied to the Commission for Jetstar to code share with Japan Airlines on the Cairns–Tokyo sector, as replacement for the code share arrangement between Qantas and Japan Airlines.

6.6 Little has changed in the Australia – Japan market since the Commission's June 2008 review of code sharing on the Cairns–Tokyo sector. The decline in overall traffic has continued over recent months, with no sign of recovery in the Japanese visitor market to Australia. The Commission refers interested readers to Decision [2008] IASC 212 of 16 June 2008 for discussion of the possible reasons for the ongoing weakness in the Japanese visitor market. In the continuing weak market circumstances, there is no cause for the Commission to subject the current application to the paragraph 5 criteria in the Minister's policy statement.

6.7 The Commission has reviewed the latest confidential commercial data reported to it by Qantas for Qantas' operations on the Cairns–Tokyo services since the recent review of the route in June 2008. Yields on the sector remain subdued, as they have on all Japan sectors on which Qantas reports data to the Commission. Overall, this review

suggests to the Commission that the code share partners have not been pricing in a way which is detrimental to public benefits on the route. The Commission accepts that the significant increase in fuel prices over the last year would have exacerbated the poor financial performance of operations on the Japan route. The combination of weak yields, falling demand and cost pressures have been the catalyst for the major changes to the Qantas-group's operations on the Japan route through 2008.

6.8 The Commission notes that the Qantas/Japan Airlines 'seat-exchange' code share arrangements on the Cairns–Tokyo sector, which are similar in effect to block space code share arrangements, will be replaced by free-sale code share arrangements between Jetstar and Japan Airlines. Under the new arrangements, there will be a significant reduction in the number of seats being operated by Jetstar compared with Qantas. However, the Commission recognises this has been driven by the weakness in the market and Qantas' decision to cease operations from Cairns.

6.9 While free-sale arrangements, by their nature, are likely to stimulate a lesser degree of competition than block space arrangements, nevertheless the arrangements do maintain Japan Airlines' presence in the Cairns–Tokyo sector. Japan Airlines would, in the Commission's view, be unlikely to enter this sector in its own right. The Commission has also previously authorised free-sale code sharing between Jetstar and Japan Airlines on the Sydney/Brisbane – Osaka sectors.

6.10 The Commission is satisfied that there would be no lessening of public benefits by allowing code sharing in this case. The Commission considers that in an environment where demand from Japanese visitors has been in decline for several years, and with a relatively weak Japanese economy, Jetstar's ability to establish itself in the Tokyo market will be enhanced by the assistance of Japan Airlines in the marketing of the new services and of Cairns as a destination. There is little prospect of anti-competitive behaviour arising from the arrangement in these circumstances.

6.11 However, as noted above, the Commission has maintained short-term approvals of other code sharing arrangements (between Qantas and Japan Airlines and between Jetstar and Japan Airlines) on the Japan route because of concerns about the potential longer term impact of the arrangements on competition if the market recovers unexpectedly strongly.

6.12 For these reasons, the Commission will limit the duration of its approval in this case to 31 December 2010, as sought by Qantas. The Commission will maintain its usual conditions requiring Qantas to report six-monthly on traffic carried by Japan Airlines on Jetstar's services and Jetstar's revenue yields for the Cairns – Tokyo code share sector.

6.13 The Commission will also remove redundant conditions relating to the code share agreement between Qantas and Japan Airlines under Determination [2006] IASC 117, as requested by Qantas. These changes apply to the Melbourne-Tokyo and Cairns-Tokyo sectors. Qantas has ceased operations on the former sector and will cease operations on the latter sector on 17 December 2008.

7 Decision [2008] IASC 215

7.1 In accordance with section 24 of the Act, the Commission varies Determination [2006] IASC 117 as requested by Qantas, by :

adding with effect from 18 December 2008

- “the capacity may be used by any wholly-owned subsidiary of Qantas to provide joint services with Qantas;
- to the extent that the capacity is used to provide joint services on the route, Qantas and any wholly-owned subsidiary of Qantas must take all reasonable steps to ensure that passengers are informed of the carrier actually operating the flight at the time of booking;”

adding with effect from 18 December 2008

- “Jetstar may use the capacity to provide services jointly with Japan Airlines until 31 December 2010 in accordance with:
 - the code share agreement of 9 February 2007, as amended, with such additional conditions (if any) as the Commission may require prior to code share services commencing, or as varied except in relation to:
 - Cairns–Tokyo being the city pair served; or
 - any financial adjustment; or
- Jetstar must submit to the Commission reports six-monthly on the number of code share seats sold by Japan Airlines on Jetstar–operated services between Cairns–Tokyo; and Jetstar’s yields per revenue passenger kilometre for all passenger classes on these services”

deleting with effect from 18 December 2008

- “Qantas may use the capacity to provide services jointly with Japan Airlines until end June 2008 in accordance with:
 - the Codeshare Services Agreement dated 7 February 1997, or as varied except in relation to:
 - the number of seats to be exchanged exceeding 1500 per week in each direction; or
 - the city pairs served; or
 - any financial adjustment;

- variations to the Codeshare Services Agreement which relate to any of the excepted matters referred to above, subject to the prior approval of the Commission; or
- any subsequent joint service arrangements 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; and
 - Qantas must not share or pool revenues under any such agreement;
- the approval to operate joint services with Japan Airlines will be effective only while Qantas operates a minimum of 3,200 seats per week between Cairns and Tokyo. The Commission will allow Qantas some flexibility in respect of this requirement to account for short term operational or commercial factors which may arise from time to time;
- Qantas must submit to the Commission monthly reports each quarter on (a) the number of code share seats sold by Japan Airlines on Qantas' operated services between Cairns and Tokyo; and (b) Qantas' yields per revenue passenger kilometre on the Brisbane – Tokyo and Cairns – Tokyo routes for all passenger classes;”

deleting with effect from 12 September 2008

- “Qantas may use the capacity to provide services jointly with Japan Airlines until end December 2008 in accordance with:”
 - the code share agreement between Qantas and Japan Airlines dated 18 July 2002, 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 code share 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: 12 September 2008

John Martin
Chairman

Philippa Stone
Member