



**Australian Government**  

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**International Air Services Commission**

**DETERMINATION**

**Determination:** [2012] IASC 106  
**The route:** South Africa  
**The applicant:** Qantas Airways Limited  
(ACN 009 661 901) (Qantas)  
**Public Register File:** IASC/APP/201215

**The IASC has decided to grant Qantas' application for an allocation of seven services per week on the South Africa route. The determination is for five years from the date that Qantas' existing determinations on the route are revoked.**

**South African Airways is authorised to code share on Qantas' flights operated to and from South Africa until 31 December 2014, subject to conditions.**

**1 The application and submissions**

1.1 Qantas applied to the Commission on 4 July 2012 for a new determination under section 7 of the *International Air Services Act 1992* (the Act) allocating it seven frequencies per week in each direction between Australia and South Africa. This will replace existing determinations [2008] IASC 105, [2008] IASC 109, [2009] IASC 126, [2010] IASC 115 and [2012] IASC 103 (the existing determinations). Qantas has requested the new determination for a five year term, expiring five years from the date the determination is made.

1.2 Qantas has stated that if it is allocated the capacity it is requesting, it will seek revocation under Section 27AA of the Act of the existing determinations which currently allocate to it seven frequencies per week on the South Africa route.<sup>1</sup> It will request that the commencement date of the new allocation be the date of the revocation of the existing determinations.

1.3 Qantas has requested that the new determination contain a condition under section 15(2)(e) of the Act to allow South African Airways (SAA) to code share on Qantas operated flights between Australia and South Africa until 31 March 2016.

1.4 Qantas provided the Commission with a public and a confidential version of its application, with commercially sensitive information redacted from the public version. Qantas maintains that the application for the allocation of capacity meets the paragraph 4 criteria in the International Air Services Policy Statement dated 19 May 2004 (the Policy Statement) and the remainder of its application addresses its request for code sharing.

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<sup>1</sup> Throughout, references to the South Africa route or to the route mean to the Australia-South Africa route as a whole, including indirect services by third country carriers, unless otherwise stated. The direct Sydney-Johannesburg and Perth-Johannesburg routes are referred to as the Sydney and Perth routes respectively.

1.5 Qantas says that the route is long, thin and isolated, requiring large aircraft with little flexibility to adjust to changes in demand. Qantas says that without the code share neither party would be able to maintain the current number of frequencies in the medium to long term.

1.6 Qantas says that the code share is a reciprocal hard block arrangement under which the marketing carrier is exposed to losses if pre-purchased seats are not sold. Qantas submits that it does not set a "price floor" under fares by charging SAA a high price for the seat blocks, saying that the method it uses to price the blocks is exactly the same as it uses to estimate and manage its own costs. Qantas claims that there is fair competition between the two airlines, particularly for business passengers. According to Qantas, third country carriers provide a real competitive alternative, particularly out of cities other than Sydney and Perth. Absent the code share, Qantas considers it extremely unlikely that a new airline would enter the route with direct services, or that Virgin Australia would re-enter the route. Qantas says that approval of the code share to 2016 will assist it and SAA commit to further investment on the route and that Qantas is more likely to deploy refurbished B747's on the route if the code share continues.

1.7 On 5 July 2012, the Commission published the Qantas application and a notice inviting other applications for the capacity and submissions from interested parties. Submissions were received from SAA (a public and a confidential version), an interested member of the public and the Australian Competition and Consumer Commission (ACCC). The Commission has considered all of these submissions and will refer to them where relevant.

1.8 All non-confidential material supplied by the applicant and submitters is filed on the Register of Public Documents and is available on the Commission's website ([iasc.gov.au](http://iasc.gov.au)). The confidential versions of the Qantas and SAA submissions are filed on the Commission's confidential register.

1.9 The Commission has analysed a considerable amount of data to assess the likely public benefit from the code share. The data includes information held by government agencies such as the Australian Bureau of Statistics (ABS) and the Bureau of Infrastructure, Transport and Regional Economics (BITRE); commercial-in-confidence material provided by Qantas; data on fares on the Australia-South Africa route provided by Qantas; and fare information available on on-line web sites.

1.10 Also, on 10 August 2012, the Commission had a teleconference discussion with its economic consultant, Dr Chris Pleatsikas, on economic principles relevant to its assessment of the code share application. Dr Pleatsikas also provided written comments on Qantas' submission in response to the Draft Determination. Dr Pleatsikas' comments were provided to Qantas and are available on the Commission's website.

## **2 The Draft Determination**

2.1 The Commission issued Draft Determination [2012] IASC 106d on 14 September 2012. In its Draft Determination the Commission proposed to allocate Qantas seven services per week on the South Africa route for five years from the date that Qantas' existing determinations on the route are revoked. The Commission proposed to include a condition in

its determination authorising SAA to code share on Qantas' flights operated to and from South Africa until 31 December 2014.

2.2 In the Draft Determination, the IASC explained its reasons for limiting the term of authorisation for the code share arrangement. The Commission accepted that there are likely to be marginal public benefits gained from approving the code share for the next two years. However, the Commission indicated that it is not satisfied that the code share would be of benefit to the public beyond 2014. After 2014 the Commission considers there is a greater prospect of two carriers competing directly on one or both of the Sydney and Perth routes, or possibly on another city pair. In a situation where it may be economic for two carriers to operate competing services on direct routes, the Commission is of the view that the code share arrangement could hinder rather than promote competition by deterring or delaying the introduction of competing services and increasing barriers to entry.

2.3 Submissions on the Draft Determination were invited and received from an interested member of the public and from Qantas.

2.4 The interested member of the public says that the IASC has failed to act in the best interest of the public, and as a result the public will be subject to a monopolistic arrangement that will cost them tens of millions of dollars over the next two years and possibly longer.

2.5 Qantas' submission is available on the IASC website. In short, Qantas accepts the terms of the Draft Determination which authorises the code share to 31 December 2014. Qantas also submits that:

- It is important to have a "home carrier" at each end of the route and absent the code share, it would be difficult to maintain current demand on the route.
- Expected future growth in market demand does not mean that there is a greater prospect of two carriers offering direct parallel services.
- Qantas and SAA engage in vigorous competition on the route.
- Hard block capacity is charged out to the marketing carrier on a straight cost pass through basis. Therefore, the costs that the marketing carrier contributes to are the same costs that it would incur if it operated its own flight on the route. This permits the two carriers to compete as though they both operated smaller aircraft.
- There are substantial (not marginal) public benefits arising from approving the code share until the end of 2014.

### **3 Requirements under the Act and the Policy Statement**

3.1 Qantas has applied for a determination under section 7 of the Act for an allocation of capacity on the route and for a condition in the determination under section 15(2)(e) to allow SAA to code share on Qantas operated flights on the route until 31 March 2016.

3.2 Under section 7 a determination must not allocate available capacity unless the Commission is satisfied that the allocation would be of benefit to the public. In assessing the benefit to the public, the Commission must apply the criteria set out for that purpose in the policy statement made by the Minister under section 11.

3.3 Under paragraph 4 of the Policy Statement, the use of entitlements by Australian carriers under a bilateral arrangement is of benefit to the public if such carriers are reasonably capable of obtaining the necessary approvals to operate on the route and are reasonably capable of implementing their applications.

3.4 Section 15(1) of the Act states that a determination may include such conditions as the Commission thinks fit. Without limiting subsection (1), the determination must include a condition stating the extent (if any) to which any such carrier may use that capacity by providing joint international air services with another Australian carrier or any other person (section 15(2)(e)). Under section 4, "joint international air services" includes, but is not limited to, code sharing and blocked space arrangements.

3.5 As the operating carrier, Qantas requires the Commission's authorisation to use its allocation of capacity to allow SAA to code share on Qantas' services between Sydney and Johannesburg. The code share agreement also involves Qantas code sharing on SAA flights between Perth and Johannesburg. However, no approval for this is required from the Commission as under the Australia-South Africa air services arrangements Qantas as the marketing carrier is not using Australian capacity entitlements. Relevant provisions of the air services arrangements are outlined in **Attachment A**.

3.6 When considering applications for capacity which include a request for a condition to allow for code sharing, the Commission must decide whether such use of capacity would be of benefit to the public. Paragraph 3.6 of the Policy Statement states that where capacity can be used for code sharing under air services arrangements, the Commission would generally be expected to authorise applications for use of capacity to code share. However, if the Commission has serious concerns that a code share application may not be of benefit to the public, the Policy Statement says that it may subject the application to a more detailed assessment using the additional criteria set out in paragraph 5 (whether the application is contested or not). Before doing so, the Commission will consult the ACCC, which it has done in this case.

3.7 In the current matter, the Commission has serious concerns that the code share arrangement may not be of benefit to the public. The Commission has expressed its concerns in previous decisions. They relate to the entrenching of Qantas' position as the monopoly operator of direct services on the Sydney route and SAA's position as the monopoly operator of direct services on the Perth route, the way in which the operating carrier charges the marketing carrier for its block of seats, the weak competitive constraint on the parties' direct services posed by third country carriers, and the potential for the code share arrangement to increase barriers to entry.

3.8 The criteria in paragraph 5.1 comprise competition, tourism, consumer, trade and aviation industry benefits and any other criteria that the Commission may consider relevant. Paragraph 5.2 of the Policy Statement states that the Commission is not obliged to apply all the criteria set out in paragraph 5.1, and that in applying all criteria it should take as the preeminent consideration, the competition benefits of each application.

3.9 The Commission will assess Qantas' application against all the paragraph 5 criteria. In doing so, in accordance with paragraph 5.2 of the Policy Statement, the Commission will take as its preeminent consideration the competition benefits of the application.

## **4 Role of the ACCC**

4.1 The Policy Statement requires the Commission to consult with the ACCC before subjecting the application to more detailed assessment using the additional criteria set out in paragraph 5 of the Policy Statement. The Commission has complied with this requirement and received a public submission from the ACCC.

4.2 The Policy Statement and its associated Explanatory Statement 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.

## **5 The new determination**

5.1 Qantas is an established international carrier which is clearly capable of obtaining the necessary approvals to operate on the route and of implementing its application. This means that, under paragraph 4 of the Policy Statement, it is of benefit to the public to allocate the capacity requested by Qantas. Accordingly, the Commission has decided to allocate to Qantas the seven frequencies per week it has sought. As requested by Qantas, the Commission has decided that the determination take effect on the date on which Qantas' existing determinations allocating capacity on the route are revoked.

5.2 The remainder of this determination addresses Qantas' request for a condition in the determination allowing SAA to code share on Qantas operated flights between Australia and South Africa.

## **6 The code share agreement**

6.1 Qantas has previously indicated that under the code share arrangement, Qantas and SAA agree to provide specified services on the Sydney and Perth-Johannesburg routes respectively, and each operating airline agrees to supply the other with a specified percentage of the seats on their agreed flights. The code share is a hard block arrangement which means that SAA as a marketing carrier pre-purchases a fixed block (40%) of seats on Qantas' Sydney services and cannot hand any back to Qantas. The fixed price paid for the seats is determined by the equivalent percentage of Qantas' total costs of the flight, excluding costs relating to marketing and freight (which is not included in the code share). All seats are required to be priced and marketed independently and SAA carries the loss if it does not sell enough seats to cover the cost of the pre-purchased block. Reciprocal arrangements apply to Qantas' code share on SAA's Perth services. The code share can be terminated by either party with 12 months notice.

### Previous IASC decisions

6.2 The Commission has authorised code sharing between Qantas and SAA on a continuing basis since December 2000. However, the Commission has maintained short-term periods of approval, one or two years at a time, because of concerns that the code share may not be of benefit to the public over a longer period when circumstances may change. The Commission has also maintained various conditions of approval designed to encourage

competition between the code share partners, such as minimum numbers of weekly frequencies which must be operated and independent pricing.

6.3 In its reviews in 2007 and 2008, the Commission recorded its concerns about high air fares and rising load factors on the direct services. However, in its December 2008 review, the Commission welcomed major changes to the Australia-South Africa air services arrangements in mid-2008 which had resulted in a large increase in capacity available to Australian and South African carriers. Until that time, there was no capacity available for expansion by Qantas or SAA or for new entrants. The constrained capacity also meant that there was little incentive for the two code share partners to compete strongly through their code share blocks because aircraft were already very full.

6.4 In extending the code share approval for two years from the end of December 2008, the Commission took account of Qantas' plans to increase its services from five to seven per week by April 2009 and, more importantly, of V Australia's plans to enter the route and fully use its allocated capacity of five weekly frequencies by October 2009. The Commission was also aware that there was scope for SAA to increase frequencies to Perth above its then five weekly flights. The Commission considered that these developments were likely to lead to substantially better public benefit outcomes, particularly once V Australia entered the route.

6.5 In September 2010, as a result of V Australia's decision to withdraw (announced on 26 August 2010, between a first and a second draft decision) the Commission strengthened the conditions in its final decision by increasing the combined minimum number of services Qantas and SAA must operate from 12 to 14 services per week. It also stated that "If, by the time of the next review in mid 2011, there is evidence that the public benefit indicators have turned down, the Commission is likely to be very inclined towards not granting a further extension ...beyond 2011." The decision made it clear that expansion plans and pricing behaviour by Qantas and SAA in the period following V Australia's departure would be an important consideration.

6.6 In its February 2012 decision ([2012] IASC 201), the Commission expressed concern that the duopoly market structure, with repeated market interaction between the parties and little competitive constraint from third country airlines or threat of entry appeared to substantially limit the intensity of competition between the two carriers. The Commission found that, except in the very short run, the code share airline has little incentive to price fares below the price it pays to the operating airline (and even these incentives would be attenuated by the nature of the interactions between the airlines). If deep cuts became persistent, the Commission concluded that the airlines would be better off exiting the code share (since deep price cuts would likely be unprofitable except at unrealistically high load factors) and retreating to a monopoly position on their respective routes. The Commission was also concerned that, over the longer term, the existence of the code share may be an impediment to a new airline entering the route.

6.7 The Commission extended approval of the code share to 31 December 2012, instead of the five years requested by Qantas. In doing so, the Commission expressed the view that, as matters then stood, the approval of the code share should not be extended beyond 2012. In response to arguments put forward by Qantas and SAA in submissions on the draft decision, the Commission reduced the combined minimum number of services that the airlines must operate from 14 to 10 per week, in line with a condition included in the South African Competition Commission (SACC) decision of July 2011 (see below).

6.8 In March 2012 Qantas applied to the Federal Court of Australia for a judicial review of the February 2012 decision. In May 2012 the proceedings in the Federal Court were discontinued by consent. In July 2012 the Commission approved an application by Qantas for an interim authorisation of the code share until 31 March 2013, pending receipt and consideration of this application.

#### Competition Commission of South Africa (SACC)

6.9 On 26 July 2011 the SACC granted an exemption certificate to SAA to allow its code share agreement with Qantas to continue until 31 December 2012. In advising SAA of the decision the SACC noted that the agreement had been exempted a number of times and for this reason, "the Commission would like to convey its apprehension regarding any further exemption." The exemption contains a number of conditions, several of which are similar to conditions contained in previous IASC decisions. These include a requirement for SAA and Qantas to price and sell their tickets independently of each other, a prohibition on sharing or pooling revenues and a stipulation that the exemption will only be applicable while SAA and Qantas together operate a minimum of 10 services per week. Prior notification and reasons are required if the airlines decide either to increase or decrease their frequencies.

6.10 In its submission SAA said that it would shortly be submitting an application for the extension of the code share to the SACC. The SACC published receipt of SAA's application on 19 October 2012.

## **7 Traffic, capacity and services on the route**

### Australia-South Africa traffic<sup>2</sup>

7.1 Of Australia's international routes, South Africa is ranked 20th in terms of origin/destination traffic<sup>3</sup>, accounting for 1.0% of total international traffic to and from Australia. Table 1 below gives the total number of passenger movements on services between Australia and South Africa on direct and indirect services and is made up of origin/destination passengers, as well as passengers travelling through Australia and/or South Africa to or from points beyond the other country. In the year ended 31 May 2012 total passenger movements between Australia and South Africa numbered some 368,000. Through traffic made up 21.3% of the passengers travelling between the two countries.

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<sup>2</sup> All annual traffic statistics are for years ended 31 May unless otherwise stated.

<sup>3</sup> Origin/destination traffic means Australian residents visiting South Africa as their main destination and South Africans visiting Australia.

<b>AUSTRALIA - SOUTH AFRICA air passenger market</b>										Compound
	Years ended May								Share of	annual
	2005	2006	2007	2008	2009	2010	2011	2012	Traffic	growth rate
Direct (origin/destination)	146,859	151,088	166,470	184,295	190,284	201,725	234,880	204,021	55.4%	4.8%
(Annual % change)		2.9%	10.2%	10.7%	3.2%	6.0%	16.4%	-13.1%		
Indirect (origin/destination)	63,410	72,164	83,072	86,757	82,055	76,998	76,027	85,559	23.3%	4.4%
(Annual % change)		13.8%	15.1%	4.4%	-5.4%	-6.2%	-1.3%	12.5%		
Through	61,273	59,099	60,157	67,341	66,556	68,027	78,628	78,412	21.3%	3.6%
(Annual % change)		-3.5%	1.8%	11.9%	-1.2%	2.2%	15.6%	-0.3%		
Total Market	271,542	282,351	309,699	338,394	338,895	346,750	389,535	367,992	100.0%	4.4%
(Annual % change)		4.0%	9.7%	9.3%	0.1%	2.3%	12.3%	-5.5%		

**BITRE:** information derived from passenger card data from the Department of Immigration and Citizenship

7.2 Origin/destination traffic growth has fluctuated considerably in recent years, influenced by one off events such as the FIFA World Cup hosted by South Africa in mid 2010 and the withdrawal of V Australia in February 2011. Nonetheless, notwithstanding a generally unfavourable global economic environment in recent years, origin/destination traffic has been trending up at a compounding average annual rate of 4.7%<sup>4</sup> over the past seven years (2005-2012). As Table 2 below shows, growth in traffic carried (all passengers on board) on the direct services operated by Qantas has been growing at a slightly higher compounding average annual rate, of 5.7% since 2005.

<b>Years ended 31 May</b>				
<b>Qantas - Sydney</b>				
	Passengers	Seats	Load factor	Growth Passengers
2002	139,515	178,083	78.3%	
2003	143,019	171,096	83.6%	2.5%
2004	152,903	190,802	80.1%	6.9%
2005	135,013	161,590	83.6%	-11.7%
2006	137,196	176,414	77.8%	1.6%
2007	154,237	196,126	78.6%	12.4%
2008	169,312	202,590	83.6%	9.8%
2009	171,548	203,692	84.2%	1.3%
2010	171,511	216,705	79.1%	0.0%
2011	179,195	244,296	73.4%	4.5%
2012	199,070	254,756	78.1%	11.1%
<b>Average annual growth</b>				
2002-2012	3.6%	3.6%		
2005-2012	5.7%	6.7%		
2009-2012	5.1%	7.7%		

<sup>4</sup> This includes both direct and indirect origin/destination traffic.

Years ended 31 May South Africa - Perth	Growth			
	Passengers	Seats	Load factor	Passengers
2002	89,430	131,587	68.0%	
2003	93,904	126,045	74.5%	5.0%
2004	93,609	142,962	65.5%	-0.3%
2005	92,550	126,265	73.3%	-1.1%
2006	88,550	125,468	70.6%	-4.3%
2007	92,579	131,926	70.2%	4.5%
2008	106,653	135,470	78.7%	15.2%
2009	112,171	148,860	75.4%	5.2%
2010	121,495	183,377	66.3%	8.3%
2011	123,206	190,244	64.8%	1.4%
2012	122,051	163,930	74.5%	-0.9%
<b>Average annual growth</b>				
2002-2012	3.2%	2.2%		
2005-2012	4.0%	3.8%		
2009-2012	2.9%	3.3%		

Data in this table was supplied by the airlines to the BITRE

7.3 As table 2 shows, with the exception of 2011, Qantas' average annual load factors historically have exceeded 75% and in the latest year reached 78%. Were traffic to continue to grow at similar rates as in the past and Qantas maintained its capacity at seven B747 services per week, load factors could be expected to rise substantially. SAA's load factors on the Perth route have been somewhat lower, although they too are set to rise if growth continues at current rates and SAA does not increase capacity.

7.4 In 2012 South Africans visiting Australia did so mainly to visit friends and relatives (40.9%) or to holiday (28.5%). 15.7% of South African visitors were in Australia for business reasons. 42.3% of Australians visiting South Africa recorded holiday as the main reason for travel, with 33.5% visiting friends and relatives and 13.9% travelling for business. Small percentages of travellers gave conventions, education and employment as their reasons for travel. This journey purpose profile has not changed significantly over recent years.<sup>5</sup>

#### Capacity growth and airline market shares

7.5 Following the negotiation of a substantial increase in capacity between the Australian and South African Governments in mid 2008, services increased significantly. SAA began substituting larger A340-600 for A340-200 and 300 aircraft in mid 2008 and went to daily services in September 2009; Qantas added a sixth weekly B747 service in December 2008 and a seventh in September 2010; and in March 2010 V Australia commenced twice weekly B777-300ER services between Melbourne and Johannesburg, increasing to three weekly services in December 2010.

7.6 By March 2010 capacity on the direct routes had grown by over 50% since 2008, resulting in average load factors across the three direct carriers falling from 81.6% in 2008 to 73% in 2010<sup>6</sup>. In its final decision in September 2010 approving the code share, the Commission noted that, even with the withdrawal by V Australia in February 2011, the code share partners alone would be operating 40% more capacity than they were two years previously.

<sup>5</sup> BITRE: information derived from passenger card data from the Department of Immigration and Citizenship.

<sup>6</sup> BITRE: from data supplied by the airlines.

7.7 In addition to the withdrawal of V Australia, in February 2011 SAA replaced its A340-600 aircraft with smaller A340-300 aircraft and in May 2011, with the consent of the Commission, reduced its services to six per week. The Commission agreed to this reduction of services in light of the exceptional circumstances that were affecting the commercial performance of SAA on the route. In its submission SAA says that it will be introducing a seventh weekly frequency from 17 August 2012 (which it has done).

7.8 Qantas says in its submission that third country carriers provide a real competitive alternative, particularly out of cities other than Sydney and Perth, and that the additional time involved in using third country carriers is often compensated for by cheaper fares and the elimination of domestic connections.

7.9 A number of third country airlines provide services between Australia and South Africa by linking their Australia and South Africa services over their home countries. These airlines include Singapore Airlines, Emirates, Etihad, Cathay Pacific, Thai Airways and Qatar Airways.

7.10 In 2012 some 73% of origin-destination passengers travelled on the direct services operated by Qantas and SAA. The remaining 27% of passengers with a destination of Australia or South Africa travelled via third-countries on airlines such as Singapore Airlines, Malaysia Airlines and Emirates.<sup>7</sup>

7.11 Unlike, for instance, on the Australia-UK/Europe routes, third country carriers competing in the Australia-South Africa market are a considerable distance from the route and are competing with non-stop services. Considerably longer travel times on one stop services suggests that they offer a poor substitute and limited competitive constraint for the direct services offered by the code share partners, Qantas and SAA, especially in the time-sensitive business market and on the Sydney and Perth routes. Of the main third country carriers, Singapore Airlines offers the shortest travelling times. However, flying on Singapore Airlines between Sydney and Johannesburg via Singapore still takes about 50% longer than on Qantas' direct service and flying between Perth and Johannesburg via Singapore is some seven hours, or 65%, longer than on SAA's non-stop service. When broken down into shares of route sectors with direct services and those without direct services, the third country airline share of the former was 18% for Sydney and 15% for Perth.

7.12 For Brisbane and Melbourne inbound and outbound passengers, a one stop service via third countries provides a closer substitute to the alternative of flying on Qantas via Sydney or on SAA via Perth. For Brisbane and Melbourne passengers travel times on one stop routes via third countries are only 10-20% longer than flying via Sydney. With lower fares being offered for flights which take only 10-20% longer, Melbourne and Brisbane origin/destination passengers show a strong preference for third country carriers. Port of clearance data for the year ended 31 May 2012 shows that in the case of Brisbane, 38.7% of origin/destination passengers departing and arriving at Brisbane travelled on Singapore Airlines. Singapore Airlines carried 23.8% of origin/destination passenger traffic into and out of Melbourne, compared with 9.9% for Qantas.<sup>8</sup>

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<sup>7</sup> BITRE: information derived from passenger card data from the Department of Immigration and Citizenship. The 55.4% of direct origin/destination traffic in table 1, page 6, is a percentage of all traffic on the route, including through traffic.

<sup>8</sup> BITRE: information derived from passenger card data from the Department of Immigration and Citizenship.

7.13 In the Commission's view third country carriers will likely continue to provide very limited competition from the code share gateway cities of Sydney and Perth. The time penalty in terms of total travel times is too great for third country carriers to compete strongly against the direct services, except for passengers who either need to make stops in those third countries or the least time sensitive passengers.

7.14 In the Commission's view significant competitive pressure on the code share parties, especially in relation to flights to and from Sydney and Perth, can only come from the entry of a new carrier operating direct services. As the Commission found in its previous decision, it is clear from the experience with V Australia's entry on the Melbourne-Johannesburg route that entry with a direct service has a much more profound impact on competition than third country carriers. In that instance, V Australia's presence had a significant impact on economy fares offered by Qantas out of Melbourne, which were in the order of between 6% and 18% lower than those it offered out of Sydney while V Australia was operating. Once V Australia left the route, Qantas' fares out of Melbourne reverted to being the same as for Sydney.

## **8 The Commission's assessment of competition benefits against the paragraph 5 criteria**

8.1 Paragraph 5 of the Minister's policy statement provides that in assessing the extent to which an application will contribute to the development of a competitive environment for the provision of international air services, the Commission should have regard to:

- the need for Australian carriers to be able to compete effectively with one another and the carriers of foreign countries;
- the number of carriers on a particular route and the existing distribution of capacity between Australian carriers;
- prospects for lower tariffs, increased choice and frequency of service and innovative product differentiation;
- the extent to which applicants are proposing to provide capacity on aircraft they will operate themselves;
- the provisions of any commercial agreements between an applicant and another carrier affecting services on the route but only to the extent of determining comparative benefits between competing applications;
- any determinations made by the Australian Competition and Consumer Commission or the Australian Competition Tribunal in relation to a carrier using Australian entitlements under a bilateral arrangement on all or part of the route; and
- any decisions or notifications made by the Australian Competition and Consumer Commission in relation to a carrier using Australian entitlements under a bilateral arrangement on all or part of the route."

8.2 In assessing the application against the statutory test, having regard to the paragraph 5 criteria, the Commission has considered the incentives for competition that the code share arrangement creates and the incentives for competition that it removes, relative to the incentives in a future without the code share arrangement (the 'counterfactual').

### The counterfactual

8.3 The general consensus in submissions is that the likely future with the code share agreement in place will be a continuation of the status quo.

8.4 In contrast, there is a range of possible scenarios of what a future without the code share (the counterfactual) might look like. The most canvassed scenarios in submissions are:

- a. each code share airline continues to operate their respective routes - i.e. Qantas operates Sydney services and SAA operates Perth services as route monopolists with the same or similar levels of capacity
- b. each code share airline continues to operate as route monopolists with each reducing capacity
- c. one or other airline exits, leaving one direct operator on both routes
- d. one or other airline exits, attracting a new Australian or South African entrant
- e. SAA commences new (parallel) Sydney services in competition with Qantas' Sydney services
- f. Qantas commences new (parallel) Perth services in competition with SAA's Perth services
- g. a new airline enters one or both routes offering direct services in competition with Qantas and SAA.

8.5 The Commission takes the view that it is not likely that a third direct carrier would enter in competition with Qantas on the Sydney route or SAA on the Perth route (i.e. scenario g) within the next two years (or enter the route on a different city pairing). The Commission notes that on this occasion, unlike in 2011, Virgin Australia has not made a submission. Since the Commission's February 2012 Decision, Virgin Australia has announced and commenced code share services between Australia and South Africa via Singapore under its alliance with Singapore Airlines. This suggests to the Commission that Virgin Australia is unlikely to introduce direct services in competition with Qantas and/or SAA in the short term (that is, around the next two years). The Commission is mindful that there are many factors driving carrier entry decisions and a change in demand-side or supply-side conditions can fundamentally alter a carrier's entry decision. Nonetheless, the Commission considers that there is more prospect of entry by a third direct carrier after 2014, absent the code share, given the data on growth in passenger traffic (see paragraphs 7.1-2).

8.6 The Commission takes the view that it is not likely that the code share airlines would introduce parallel services on one or both routes within the next two years (i.e. scenarios e and f), or commence direct services on a new city pairing, absent the code share. However, after 2014 the Commission considers there is a greater prospect of two carriers operating parallel services, assuming trend growth in passenger traffic continues.

8.7 The Commission also considers that one or other of Qantas and SAA exiting the market (scenarios c and d in paragraph 8.4) is not a likely counterfactual scenario within the next two years. There is no evidence before the Commission indicating that the carriers

would not be able to recover at least the incremental cost of their operating services absent the code share.

8.8 The Commission notes that Qantas and SAA submit that the most likely counterfactual scenario involves each code share airline continuing to operate their respective routes as monopolists with each monopolist reducing capacity below current levels (i.e. consistent with scenario b in paragraph 8.4). Qantas believes neither party would be able to maintain the current number of frequencies in the medium to long term and SAA submits that the daily one stop services would most probably cease in the current high-cost environment without traffic support from each other.

8.9 The carriers' submissions seem to be based on an assumption that the level of passenger demand will decline (relative to 2012 levels) in the medium and long term without a home carrier at either end to provide traffic support.

8.10 In the Draft Determination, the Commission indicated that it was difficult to reconcile such an assumption with the observed growth in services offered by third country carriers (with no home carrier status). The Commission notes that some 85% of passengers travelling between South Africa and cities such as Brisbane or Melbourne choose to fly with third country carriers in preference to the one stop service offered by the home carriers. The Commission also noted in its Draft Determination that the parties did not appear to have considered how Virgin Australia, Air New Zealand or any of the third country carriers offering indirect services between Australia and South Africa might react if they were to reduce the frequency of direct services and whether, given those reactions, it would be in the carriers' commercial interests to reduce capacity on direct services below 2012 levels in the medium to long term.

8.11 In its response to the Draft Determination, Qantas repeated its contention that a home carrier presence at each end of the route is important and submitted that absent the code share, it would be difficult for Qantas to maintain current demand for its services without building a comprehensive marketing, sales or network presence in South Africa, which would not be commercially viable.

8.12 The Commission is not persuaded that a home carrier presence at either end of the route is as important as Qantas suggests. While some customers may find it advantageous to be able to buy a single ticket inclusive of a connecting domestic flight and/or prefer to buy their ticket from a home carrier, it is not clear that a substantial proportion of passenger traffic would strongly prefer these features over other criteria such as cheap fares. Many customers do not require a connecting domestic flight and have shown a strong preference for cheap fares over a home carrier (as evidenced by airline market shares for the Brisbane-Johannesburg route). Moreover, the Commission considers that the code share agreement is not the only means by which the parties are able to meet the demands of customers who have a strong preference for a single ticket inclusive of a connecting domestic flight or a strong preference for a home carrier. For example, Qantas might enter into an interline or code share arrangement with another South African airline and SAA might enter into an interline or code share arrangement with Virgin Australia for direct services (to complement its indirect service offering through its alliance with Singapore Airlines).

8.13 The Commission considers that the key drivers of growth for air passenger services between Australia and South Africa are likely to be:

- factors unrelated to the code share, such as underlying economic conditions (especially GDP growth), population growth, currency exchange rates and growth in tourism/business opportunities; and
- the price of air passenger services, including fares charged by the code share airlines. With or without the code share, Qantas and SAA have an ability and incentive to stimulate (limit) traffic by lowering (increasing) fares.

8.14 Notwithstanding fluctuating annual growth rates, the Commission notes that origin/destination traffic (direct and indirect) has been growing at a (compounding) average annual rate of 4.5% over the last 15 years.<sup>9</sup> Since 2009 traffic has grown at a (compounding) average annual rate of 5.1% on the Sydney route and 2.9% on the Perth route. The Commission also notes that Tourism Australia has forecast international visitor arrivals to Australia from South Africa to grow at a compounding average annual rate of 5.5% between 2010-11 and 2015-16.<sup>10</sup> In a growing market, and a market in which Qantas and SAA can themselves influence demand by varying fares, it is not clear why the code share partners would find it necessary to shed capacity to below 2012 levels absent the code share.

8.15 The Commission therefore considers that scenario b in paragraph 8.4 (i.e. route monopolists with reduced capacity) is a less likely scenario than scenario a (i.e. route monopolists with the same or similar capacity), particularly in the medium to long term.

8.16 Based on the information currently before the Commission, it is minded to accept that the most likely counterfactual for the next two years involves each airline operating their respective routes as monopolists, but with levels of capacity similar to those that they would offer under the code share agreement. The Commission expects that in the future, both with and without the code share, the carriers would have some incentive to add capacity as demand grows. While it is possible that one or both airlines may initially reduce capacity if the Commission does not approve the code share, any such reduction is likely to be small and short-lived given expected traffic growth rates.

8.17 However, the Commission considers that, assuming current trends in demand growth continue, there is a greater prospect of two carriers offering parallel services on one or both direct routes sometime after 2014. The Commission notes that the two carriers need not be Qantas and SAA. The Commission further notes that it is unlikely to be necessary for both carriers to offer daily services in order for parallel services to be commercially viable.

8.18 Accordingly, the Commission considers that it is appropriate to bifurcate the counterfactual into two periods: the period up to the end of 2014; and the period beyond 2014. For the period up to the end of 2014, the Commission considers that the likely counterfactual involves each airline operating their respective routes as the monopoly provider of a direct service and offering similar levels of capacity as they would offer under the code share arrangement. For the period beyond 2014, the Commission considers that there is a greater prospect of two carriers offering parallel direct services on one or both routes.

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<sup>9</sup> BITRE: data derived from passenger card data from the Department of Immigration and Citizenship.

<sup>10</sup> Tourism Research Australia 2012, *Forecast 2012 Issue 1*, Department of Resources, Energy and Tourism, page 77.

## Incentives for competition created by the code share arrangement

8.19 With or without the code share, third country carriers will likely continue to provide significant competition to the code share carriers from major Australian cities that do not have direct services (e.g. Brisbane and Melbourne). They will do this by offering an alternative one-stop service to the code share airlines at attractive prices and with itineraries that impose only a relatively minor time penalty compared to the code share carrier's indirect service.

8.20 However, with or without the code share, third country carriers will likely continue to provide, as they have in the past, limited competition to the code share carriers' direct service offering out of gateway Australian cities (i.e. Sydney and Perth), which account for 55% of total traffic between Australia and South Africa (see Table 1, page 8]).

8.21 Relative to a world where SAA and Qantas are route monopolists and do not offer parallel direct services on either the Sydney or Perth routes – i.e. the likely counterfactual for the next two years – the code share arrangement may facilitate greater rivalry between SAA and Qantas for direct services. In essence, it creates a duopoly (instead of a monopoly) for the marketing and sale of direct services, while preserving monopoly provision of the direct service by the designated operating carrier.

8.22 As the Commission has recognised in past decisions, the hard block nature of the code share arrangement is generally considered to create stronger incentives for the code share partners to compete than free-sale type arrangements. This is because hard block code share arrangements create an incentive for the code share partner to sell as many seats as they can to cover the fixed cost of the blocks they have purchased from each other. Qantas considers that the arrangement can best be analogised to two airlines operating separate and distinct smaller competing flights within the body of a larger aircraft. The Commission takes a different view for the reasons outlined below.

8.23 While the hard block code share arrangement can, in theory, promote competition between Qantas and SAA in the marketing and sale of direct services, in practice the intensity of the competition created in this duopoly environment, characterised by repeated market interaction<sup>11</sup> and little threat of competition from indirect competition or new entrants, is likely to be very limited.

8.24 To begin with, the terms of the code share agreement (and, in particular, how the operating airline charges the marketing airline for its block capacity entitlement) appear to substantially limit the intensity of competition between Qantas and SAA. Each airline determines the other's cost base on the route it operates as a pro rata share of total costs attributed to the flight. It appears that the costs attributed to the flight are not confined to the incremental cost of each flight. The marketing carrier appears to be required to contribute to the operating carrier's (common) fixed costs that are not flight-specific. For example, on the Sydney route Qantas appears to require SAA to make significant contributions to: aircraft insurance costs; cabin and technical crew training and support costs (including administrative

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<sup>11</sup> This refers to the frequency with which Qantas and SAA face each other as rivals in the market place. This has important implications for the degree of rivalry between the airlines, particularly in a duopoly setting. Repeated market interaction provides each airline with an opportunity to learn its rival's behaviour over time. It also enables each airline to more effectively retaliate (e.g. by discounting fares or charging more for hard block capacity in the next period) if their rival behaves in a manner that is detrimental to the interests of both airlines. All else being equal, repeated market interaction makes it more likely that the airlines will adjust their response so as not to compete as aggressively as they otherwise would.

functions); flight support overheads; in-flight entertainment costs; aircraft depreciation and amortisation; aircraft leasing costs; station engineering costs, Australian and international airport support costs; airport support overheads, and aircraft maintenance and overhaul expenses.

8.25 In response to the Draft Determination, Qantas submitted that it is not credible that any operating carrier would sell a block of seats at incremental cost. Qantas confirmed that it charges the marketing carrier for all of the fixed costs that it would incur if it operated on the route (i.e. does not confine its charges to the incremental cost to operate the flight that the allocated seats are on).

8.26 This confirms the Commission's view that the arrangement likely limits price-based competition between the two airlines. Once an airline commits to operating on a route, in the short run it can profitably operate on the route as long as it recovers the incremental cost of each flight. Accordingly, the Commission considers that two airlines engaging in vigorous competition, at least from time to time, would be willing to accept a price for hard block capacity that allowed it to recover the incremental cost of the flight, or a bit more than incremental cost, but less than the fully attributed total cost (inclusive of network overheads and sunk costs associated with the decision to fly a route). The information provided by Qantas suggests this does not and will not happen.

8.27 Under the current arrangement, while each carrier makes its final pricing decisions independently of the other, it will do so in anticipation of the likely reaction of the other. The starting point for their price decisions is average total cost of the monopoly service provider (not incremental cost of a flight). This means that, while each airline has discretion at the margin to set the price of a seat below average total cost charged by the operating carrier, on average they must achieve fares that allow them to fully recover this cost, plus their own marketing costs, to at least break even. If they anticipate that any fare reductions are likely to be matched, the incentive to offer them will accordingly be reduced.

8.28 Moreover, in an environment where the code share carriers are able to routinely achieve average load factors above 70% in off-peak months, above 80% in peak months, and above 75% annually, as has historically been the case on the Sydney route, there is little pressure on either carrier to offer a significant number of fares at below average total cost. Going forward, the Commission is concerned about the parties' incentives to raise price on the Sydney route given, one, expected growth in passenger demand and, two, Qantas is already operating daily services. The Commission notes that Qantas has not provided any information, either in its application or in its response to the Draft Determination, on whether it proposes to increase capacity, both year round and by introducing supplementary services in peak months, in line with demand growth.

8.29 The Commission notes that the situation on the Perth route is different. Since January 2009 average monthly load factors have ranged between 52% and 87% and average annual load factors have ranged between 65% and 75%. Nevertheless, the degree of competition created by the code share agreement on the Perth route could still be quite limited because of the fragile nature of the duopoly arrangement in the sense that it only exists for as long as both parties prefer to cooperate.

8.30 If deep price cuts were to persist on either route, one or both airlines might decide they would be better off exiting the code share and retreating to a monopoly position on their respective routes. If each airline knows that if it discounts fares too far below the monopoly

price they will reduce the other airline's willingness to participate in the code share agreement, they are likely to factor this knowledge into their pricing decisions (e.g. by adopting a conservative discounting policy).

8.31 Under these conditions there is little pressure on either carrier to set prices that are significantly below what a monopolist would charge, particularly given the weak competitive threat to their direct services from third country carriers.<sup>12</sup>

8.32 Importantly, by pricing capacity blocks on the basis of a pro rata share of attributed total costs, the code share arrangement does not create competitive pressure on the operating carrier to improve costs, service levels or dynamic efficiency over time.

8.33 Qantas' comments in response to the Draft Determination have not altered the Commission's view that the characteristics of the route, combined with the nature of the code share arrangement, provide only weak incentives for the code share partners to compete on price.

8.34 Qantas has submitted that approval of a longer term code share arrangement will assist Qantas and SAA to separately commit to further investment on the route. Qantas says it is in the process of refurbishing some of its Boeing 747 aircraft with completely new interiors to the same standard as the new A380's and is more likely to deploy these aircraft on the Sydney route if the code share continues.

8.35 The Commission notes that Qantas is likely to be the sole operator of the service in the future with the code share and also in the next two years of a future without the code share. All other things being equal, Qantas generally has an incentive to prioritise the deployment of upgraded aircraft on routes where it competes with airlines offering a higher level of service and where it seeks to substantially improve capacity utilisation. On the Sydney route Qantas faces no competing operating aircraft and has consistently achieved very high load factors in peak and off peak periods. It is, therefore, not clear how the code share arrangement would increase Qantas' incentive to introduce refurbished aircraft relative to a world in which it was the monopoly operator and marketer of Sydney services.

8.36 The Commission considers that the code share arrangement is certainly unlikely to increase Qantas' incentives to use refurbished aircraft relative to a counterfactual where Qantas faced competition from an airline offering parallel direct services on the Sydney route – which the Commission considers is a potential scenario post 2014.

8.37 On this basis, the Commission considers that the only incentives for competition created by the agreement are confined to a degree of (static) price and non-price competition that is likely very limited on the Sydney route, but somewhat stronger on the Perth route. In the Commission's view, the code share does not create competitive pressure to reduce operating carrier costs or improve service over time.

8.38 Moreover, the code share only creates this very limited incentive to compete for as long as it is uneconomic for two carriers to offer parallel direct services. As noted above, the Commission considers that, absent the code share, there is a greater prospect of two carriers offering parallel services on one or both routes sometime after 2014.

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<sup>12</sup> For an explanation of how duopoly can result in near monopoly prices see George J. Stigler 1940, 'Notes on the theory of duopoly', *Journal of Political Economy*, Vol 48, pp. 521-541, available at: <http://www.intertec.org/Classics/stigler%201940.pdf>

## Incentives for competition removed by the code share arrangement

### *The future to end 2014*

8.39 In the Commission's view, relative to a future in which each code share airline retreats to a monopoly position – which the Commission accepts is the likely counterfactual in the next two years – the code share agreement is not likely to remove incentives for competition. The Commission considers that Qantas' incentives to introduce additional capacity on the Sydney route (and SAA's incentive to introduce additional capacity on the Perth route) in response to expected demand growth is unlikely to materially differ in the future with and the future without the code share agreement.

### *The future beyond 2014*

8.40 In the Commission's view, relative to a situation where there is a greater prospect of two carriers offering parallel direct services – which the Commission considers is more likely after 2014 – the code share agreement has the potential to discourage or delay competition in a variety of ways.

8.41 First, it reduces incentives for SAA to introduce parallel services on the Sydney route and for Qantas to introduce parallel services on the Perth route. As a result, it prevents or at least deters the introduction of parallel services. The Commission considers that:

- SAA is more likely to introduce parallel direct services on the Sydney route in its own right absent the code share. Qantas is likely to continue on this route, though may temporarily remove one or two weekly services depending on growth in traffic demand; and
- Qantas is more likely to introduce parallel direct services on the Perth route in its own right absent the code share. SAA is likely to continue on this route as long as it recovers incremental costs. The Commission notes that the Perth to Johannesburg service is important to its code share agreement with Air New Zealand.

8.42 For the term over which the code share deters or delays the introduction of parallel direct services, the arrangement removes incentives for stronger price and non-price competition (relative to the competition afforded absent the code share). It therefore removes competitive pressure on Qantas (on the Sydney route) and SAA (on the Perth route) to stretch their performance to further improve cost efficiency and level of service over time.

8.43 Finally, in a growing market new entry may be more likely without the code share to the extent that a new entrant would not be competing against the combined market position of the incumbent carriers. While the code share is unlikely to be the sole determinant of whether or not a new entrant will seek to compete on the route, at the margin it is likely to act as a deterrent to aspiring new entrants seeking to offer parallel direct services. Thus, in a world where the decision to enter was finely balanced, the removal of the code share could facilitate competition in the provision of direct services that would otherwise not occur or be delayed.

## The Commission's assessment of other benefits against the paragraph 5 criteria

### *Tourism benefits*

8.44 Paragraph 5 of the Minister's policy statement provides that in assessing the extent to which applications 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)."

8.45 In theory, withdrawal of the code share approval would remove the incentive for Qantas to promote Perth as a destination for prospective leisure travellers from South Africa and for SAA to promote Sydney as a destination for prospective leisure travellers from South Africa. However, there is no information before the Commission indicating that the code share airlines are proposing to make city-specific investments in market development and tourism promotion.

8.46 On this basis, the Commission is not persuaded that the code share arrangement is likely to confer tourism benefits. Beyond 2014, assuming current trends in demand growth continue, the Commission considers that the airlines' incentives to invest in the marketing and promotion of Australian destinations may be greater absent the code share.

### *Consumer benefits*

8.47 Paragraph 5 of the Minister's policy statement provides that in assessing the extent to which the applications 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 standards of service;
- 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)."

8.48 Absent market failure, consumers generally benefit from competition between airlines. Hence the Commission's analysis of consumer benefits flows directly from its analysis of competition benefits.

8.49 The continuation of the code share may provide some consumer benefits as long as the counterfactual involves monopoly provision of direct services, which the Commission accepts is likely over the next two years. However, these consumer benefits are another manifestation of the competition benefits discussed previously and are not an additional source of public benefit. Beyond 2014, when there is a greater prospect of parallel direct services on one or both routes, consumer benefits would likely be higher absent the code share.

### *Trade benefits*

8.50 Paragraph 5 of the Minister's policy statement provides that in assessing the extent to which applications will promote international trade, the Commission should have regard to the availability of frequent, low cost, reliable freight movement for Australian exporters and importers.

8.51 The code share arrangements exclude the carriage of freight. Qantas and SAA are each responsible for the sale of belly-hold capacity on the services they operate.

8.52 The Commission is not persuaded that the code share gives rise to trade benefits. If capacity is maintained at the same or similar levels in the future without the code share - which the Commission considers the most likely counterfactual scenario for the next 2 years - then a decision to approve the code share agreement would be expected to have no impact on belly-hold capacity. After 2014, when there may be parallel direct services or new entry to the route, it is possible that there would be increased belly-hold capacity and therefore greater trade benefits absent the code share.

### *Industry structure*

8.53 Paragraph 5 of the Minister's policy statement provides that "The Commission should assess the extent to which applications will impact positively on the Australian aviation industry."

8.54 From Qantas' perspective the code share arrangements had a positive effect initially on the Australian aviation industry by enabling Qantas to add capacity and provide daily services between Sydney and Johannesburg. The Commission is not persuaded, however, that Qantas' increase in capacity to daily services would not have been possible without the code share. As noted previously, the Commission considers that many of the key drivers of observed growth in passenger demand are unrelated to the code share agreement (e.g. GDP growth, population growth, exchange rate, growth in tourism/business opportunities). The Commission has also found in the past that the code share may have contributed to V Australia's losses on the route and to its eventual withdrawal. To the extent that continuation of the code share could act as a deterrent to future entry by another airline on the route, approval of the code share would not have a positive impact on the Australian aviation industry overall.

## **9 Conclusion**

9.1 The code share arrangement creates a duopoly for the marketing and sale of direct services operated solely by Qantas on the Sydney route and solely by SAA on the Perth route.

9.2 The Commission is concerned that in this duopoly environment, with repeated market interaction, the intensity of competition is greatly limited by the basis on which the operating carrier charges the marketing carrier for its block of seats; the limited competitive constraint imposed by third country carriers on the code share carriers; and the code share partner's knowledge that if it discounts fares too aggressively it might destabilise the arrangement.

9.3 In an environment in which the carriers are able to routinely achieve high load factors, there is little pressure on either carrier to offer fares materially below the monopoly

price. Also, the code share does not create any competitive pressure on the operating carrier to improve costs, service levels or dynamic efficiency over time.

9.4 In issuing this determination the Commission may include such conditions as it thinks fit. The Commission is required to include a condition stating the extent to which a carrier may use capacity allocated by providing joint international air services (s15(2)(e)). In determining whether the conditions dealing with joint international air services should permit code sharing and to what extent, the Commission has regard to the Minister's policy statement in assessing whether a particular condition will be of benefit to the public. In considering this question the Commission must look at competition benefits. In doing so it is useful to compare the state of competition in the future if the condition permitting code share is included with the likely level of competition if the code share is not permitted. The Commission considers the future without the code share may change over time. In particular:

- At least for the next two years, the Commission considers that the likely future without the code share involves each airline operating their respective routes as the monopoly provider of a direct service and offering similar levels of capacity as they would offer under the code share agreement.
- After this time, in the period beyond 2014, the Commission considers that there is a greater prospect of two carriers offering parallel direct services (either the incumbents and/or a new entrant).

9.5 This has significant implications for the Commission's assessment of public benefits and influences the extent to which the Commission considers code sharing should be allowed and for how long.

9.6 At least for the next two years, the Commission is of the view that the code share arrangement may not achieve outcomes that are materially different from what the carriers could achieve absent the arrangement. In theory, the code share could create some incentives for competition in the marketing and sale of direct services between Qantas and SAA, but in practice these are likely to be limited. While the Commission's finding on competition benefits is finely balanced, the Commission considers that there are likely to be marginal public benefits gained from approving the code share until the end of 2014.

9.7 After 2014, however, the Commission considers that there is a greater prospect of two carriers competing directly on one or both of the Sydney and Perth routes, or possibly on another city pair. In a situation where it may be economic for two carriers to operate competing services on direct routes, the Commission considers that the code share arrangement could hinder rather than promote competition. In particular, the Commission is concerned that it may deter or delay the introduction of competing services, particularly on the Sydney route, and increase barriers to entry.

9.8 Qantas has sought approval for the code share arrangement until 31 March 2016. On the basis of the public and confidential information available to it, the Commission is not satisfied that the code share would be of benefit to the public beyond 2014. Accordingly, the Commission will approve the code share until 31 December 2014. After 2014, the Commission considers there is a greater prospect of either entry and/or more competition between the incumbent airlines in the absence of the code share. Should, in 2014, Qantas decide to apply for a continuation of the code share beyond 2014, the Commission would consider the application in the light of developments between now and when an application is received.

## 10 Determination [2012] IASC 106

10.1 In accordance with section 7 of the Act, the Commission makes a determination in favour of Qantas allocating seven services per week on the South Africa route.

10.2 The determination is for five years from the date that Qantas' existing determinations on the route are revoked.

10.3 In accordance with section 15 of the Act, the determination is subject to the following conditions:

- Qantas is required to apply to have its existing determinations revoked within 10 working days of the date of this determination;
- Qantas is required to fully utilise the capacity from the date of revocation of the existing determinations;
- only Qantas is permitted to utilise the capacity;
- Qantas is not permitted to utilise the capacity to provide services jointly with another Australian carrier or another person without the approval of the Commission;
- SAA is authorised to code share on Qantas' flights operated to and from South Africa until 31 December 2014, consistent with the Qantas/SAA code share and commercial agreement 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 not share or pool revenues under any such agreement;
  - Qantas and SAA must price and sell their services on the route independently;
  - Qantas and SAA must withdraw from all IATA tariff coordination activities in relation to air fare levels between Australia and South Africa;
  - nothing in this decision exempts Qantas from complying with the Australian Consumer Law and Qantas is required to take all reasonable steps to ensure that passengers are informed, at the time of booking, of the carrier actually operating the flight;
  - the approval will remain in effect only while Qantas and SAA together operate at least thirteen services per week on the South Africa route.

Temporary reductions from this level may be permitted in exceptional circumstances, but only with the prior approval of the Commission; and

- Qantas must submit to the Commission within 30 days of the end of each quarter the following monthly data:
  - the number of seats available for sale on the Sydney services operated by Qantas (total flight by passenger class, number available to Qantas by passenger class, number available to SAA by passenger class);
  - the number of seats sold on the Sydney services operated by Qantas (total flight by passenger class, number sold by Qantas by passenger class, number sold by SAA by passenger class);
  - Qantas' yield per revenue passenger kilometre on the Sydney services (total and for each passenger class);
  - the number of seats available for sale on the Perth services operated by SAA (total flight by passenger class, number available to Qantas by passenger class);
  - the number of code share seats sold by Qantas on the Perth route (by passenger class); and
  - Qantas' yield per revenue passenger kilometre on the Perth services operated by SAA (total and for each passenger class); and
- 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 – South Africa 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 – South Africa air services arrangements.

Dated: 19 November 2012



Jill Walker  
Chairwoman



Stephen Bartos  
Member

## RELEVANT PROVISIONS IN THE BILATERAL AIR SERVICES ARRANGEMENTS

The air services arrangements between Australia and South Africa provide for the multiple designation of carriers. In relation to capacity, the number of services that the airlines of each country can operate between Australia and South Africa is 21 per week. With the return of V Australia's capacity and seven services per week allocated to Qantas, there are 14 services per week of capacity remaining available for allocation to Australian carriers.

The air services arrangements permit the designated airlines of each country to enter into code share, block space or other cooperative marketing arrangements with any other airline, including airlines of third countries. When the airlines of each country code share on the services of the other, seats purchased by the marketing carrier do not count as a use of bilateral capacity entitlements. This means that Qantas does not require permission from the Commission to code share on SAA's services. However, capacity allocated by the Commission and used by Qantas as the operating carrier is counted as a use of bilateral capacity. Under the *International Air Services Commission Act (1992)*, an Australian carrier may only use its allocated capacity in joint services with the approval of the Commission. Qantas therefore requires Commission authorisation for SAA to code share on Qantas' services.

The air services arrangements grant unrestricted intermediate and beyond fifth freedom rights (traffic rights between the other country and a third country) to the airlines of both countries, provided a commercial agreement has been concluded between the Australian and South African airlines and the services are operated jointly pursuant to that agreement. This means that an airline cannot exercise fifth freedom traffic rights independently, or through code sharing on the services of an airline of a third country.

