

DECISION

DECISION:	[2000] IASC 204
VARIATION OF:	IASC/DET/9912
THE ROUTE:	TAIWAN
THE APPLICANT:	QANTAS LIMITED (ACN 003 613 465)
PUBLIC REGISTER FILES:	IASC/APP/200008

1 The application

1.1 On 8 March 2000, an application was received from Qantas Limited (Qantas) for a variation of Determination IASC/DET/9912 (the Determination) allocating capacity on the Taiwan route.

1.2 Qantas has sought the variation to permit it to provide services jointly with Eva Air (Eva) with effect from 1 May 2000. Qantas intends to code share on three of five weekly Eva MD-11 services between Brisbane and Taipei. Qantas also proposes that Eva will code share on the three weekly Qantas services between Sydney and Taipei.

1.3 On 14 March, the Commission published a notice inviting submissions from interested parties about the application. The Australian Competition and Consumer Commission (ACCC), the Australian Tourist Commission (ATC) and the Queensland Department of State Development (Queensland Government) made submissions. All non-confidential material supplied by the applicant is filed on the Register of Public Documents.

2 Current services

2.1 Currently, Qantas, Eva and China Airlines conduct own operations on the Taiwan route. The details are as follows:

Qantas

- Sydney-Taipei v.v (three B767 services per week)

Eva Air

- Brisbane- Taipei v.v (three MD-11 services per week) – these will increase to five services per week from May 2000.
- Sydney-Taipei v.v (three B767 services per week) – these services commenced on 26 March 2000 and will cease on 30 April 2000.

China Airlines

- Sydney-Taipei v.v (three MD-11 services per week)

2.2 Air New Zealand code shares on Eva Air flights between Brisbane and Taipei with 318 seats per week. Indirect services between Australia and Taiwan are provided by a number of third country carriers, such as Cathay Pacific (via Hong Kong) and Singapore Airlines (via Singapore).

3 Characteristics of the Australia- Taiwan route

3.1 In the year ended 31 December 1999, traffic on the Australia - Taiwan route totalled approximately 387,400 passenger movements. Of these passenger movements, 71.3% were passengers with a destination of either Australia or Taiwan travelling directly between the countries (direct traffic). 24.0% of movements involved passengers travelling indirectly between the two countries (indirect traffic). The remaining 4.6% of the movements involved passengers travelling directly between Australia and Taiwan to and from countries beyond Taiwan or Australia (beyond traffic).

3.2 Direct, indirect and total traffic fell in the year ending December 1999. Beyond traffic increased by nearly 12% from a small base. Total traffic on the route has fallen, by a small amount, for each of the last three years.

Australia - Taiwan Passenger Movements
Years Ended 31 December 1996 - 31 December 1999

Traffic category	Year ended December					Compound annual growth rate 96-99
	1996	1997	1998	1999		
Direct traffic (Annual % change)	292,300	294,000 (+0.6%)	278,100 (-5.4%)	276,400 (-0.6%)	(71.3%)	-1.8%
Indirect traffic (Annual % change)	91,900	86,900 (-5.4%)	97,000 (+11.6%)	92,900 (-4.2%)	(24.0%)	0.4%

Beyond traffic	17,400	14,600	16,100	18,000	(4.6%)	1.1%
(Annual % change)		(-16.1%)	(+10.3%)	(+11.8%)		

Total traffic	401,600	395,500	391,200	387,400	(100.0%)	-1.2%
(Annual % change)		(-1.5%)	(-1.1%)	(-1.0%)		

Note: Data in this table have been derived from information supplied by the Australian Bureau of Statistics and include both scheduled and charter traffic. Figures may not add to totals due to rounding. Average annual growth records the compound annual growth rate.

3.3 In the year ended 31 December 1999, Taiwan residents comprised 81% of the passenger traffic with origin/destination Taiwan. Taiwan residents visiting Australia did so mainly for holiday and visiting relatives (79.4%) while Australians visited Taiwan mainly to visit relatives (40.9%) and for business (29.8%).

3.4 The table below shows that Qantas' market share on the Taiwan route has declined over recent years, while that of Eva has not changed significantly. Sixth freedom carriers have increased their market share substantially.

Australia – Taiwan Origin Destination Traffic by Airline

	1996	1997	1998	1999
Qantas Airways	33%	27%	23%	20%
Eva Air	16%	18%	16%	19%
Mandarin Airlines	14%	13%	13%	13%
Ansett Australia	14%	18%	17%	17%
Cathay Pacific	8%	11%	16%	16%
Air New Zealand	7%	5%	5%	4%
Singapore Airlines	5%	5%	8%	9%
Other	2%	3%	3%	2%

Note: Data in this table have been derived from information supplied by the Australian Bureau of Statistics and include both scheduled and charter traffic

4 Provisions of relevant air services arrangements

4.1 Under the Australia-Taiwan air services arrangements, the designated airlines of Australia are entitled to operate up to a total of 3,600 seats per week. Currently, Qantas has an allocation of 687 seats per week and Ansett International has an allocation of 848 seats per week. Ansett International suspended its services in February 2000 and the determination allocating its capacity expires in May 2000.

4.2 There are 2,065 seats available for allocation, which will increase to 2,913 seats if Ansett does not resume its services when its determination expires next month.

5 Applicant's claims

5.1 Qantas does not require the Commission's approval to code share on Eva's services between Brisbane and Taipei as seats marketed by Australian carriers on flights operated by Taiwan carriers are not counted against Australian entitlements under the air services arrangements

5.2 Qantas proposes to have a block of 106 seats on each of three weekly Eva flights between Brisbane and Taipei, with Eva having a block of 100 seats on each of three weekly Qantas flights between Sydney and Taipei. No charges are payable relating to this exchange of seat blocks as it is balanced on a calculation of available seat kilometres.

5.3 Qantas says it is uncertain about its ability to maintain services on the route in the absence of the proposed code share arrangements. Qantas points to the exit of Ansett International from the route as evidence of the difficulty of sustaining commercial operations to Taiwan. In these circumstances, Qantas maintains that the code share will facilitate a level of competition that may not otherwise exist.

5.4 According to Qantas, 80% of passengers on the route are Taiwan residents. Of these, 90% travel for leisure purposes. Qantas maintains that adequate frequency and capacity to Brisbane and Sydney are required to develop the Taiwan tourism market. Qantas claims that Australian consumers will benefit from the level and choice of non-stop services from both Sydney and Brisbane which the code sharing arrangements will enable.

5.5 Qantas believes that the code share arrangements will provide benefits in that it is doubtful whether it would be otherwise able to maintain its own flights between Australia and Taiwan.

6 Other submissions

6.1 The ACCC made a submission on 23 March 2000. Qantas responded on 5 April 2000 and the ACCC responded to the second Qantas submission on 10 April 2000.

6.2 The ACCC raised a number of concerns about the effects on competition of the proposed arrangements. In its view, blocked space arrangements are a prerequisite for competition benefits to occur in the context of a code share. However, even with such arrangements, there may not be competition benefits and the ACCC is concerned that code sharing on the route could reduce competition and potentially lead to higher prices as Qantas and Eva have relatively high capacity shares (29% and 45% respectively).

6.3 The ACCC says that Qantas will no longer compete on services through Brisbane and believes there would be little incentive for the airlines to compete on price. However, it notes that there appears to be strong competition on fares from Taiwan to other tourist destinations, which could outweigh the effects of any lessening of

competition, depending on how important price is in determining holiday destinations in the Taiwan market.

6.4 The ACCC suggests that Qantas be asked what features of the code share would allow it to remain in the market in the face of high load factors/ low yields that led to Ansett's withdrawal. The ACCC also says that if Eva and Qantas were to raise fares within a reasonable period after the code share was introduced, it would be a development of interest to the ACCC.

6.5 In response to the ACCC submission, Qantas says it would compete with all carriers in the market to fill its own services and the seats allocated to it on Eva flights. Qantas also says it would continue to compete on price with Eva. As it receives no revenue for the seats allocated to Eva, it is incumbent on Qantas to maximise sales on the capacity allocated to it on the Eva flights.

6.6 Qantas says that a better picture of the level of competition in the market would be obtained by considering the presence of sixth freedom carriers, rather than just the carriers offering direct services.

6.7 The Queensland Government made two submissions supporting the joint services proposal. It notes the 21.6% growth in visitor numbers to Queensland from Taiwan in 1999. In its view, continued strong growth could lead to Qantas re-introducing its own services from Brisbane. It also suggests that the additional frequencies which Qantas could sell under the proposal will enable it to obtain better 'market penetration'. It considers that competition between Qantas and Eva would continue after the proposal was implemented. It also points out that destination competition exists in the Taiwan outbound market.

6.8 The ATC supports approval of the proposal if the alternative is the withdrawal of Qantas from the market. If Qantas remains in the market, it will have more reason to work with the ATC on promotional campaigns. The ATC has provided information showing the strong degree of destination competition Australia faces from the United States and Europe in Taiwan's outbound market. The ATC understands that if Qantas' operational costs on the route are not reduced, the continued viability of the services will be under threat.

7 Commission's assessment

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

7.2 The Commission will normally apply only the general public benefit criteria in paragraph 4 of the Minister's Policy Statement when there are no submissions opposing an application for a variation. There were no such submissions in this instance. However, the ACCC has raised some concerns in relation to competition issues which it has suggested that the IASC may wish to take into account in its assessment of the

application. Accordingly, consistent with paragraph 6.3 of the Policy Statement, the Commission has decided to utilise the additional public benefit criteria contained in paragraph 5 of the Policy Statement in assessing this application.

7.3 The Commission has to decide whether the variation sought to the determination would be of benefit to the public. In deciding this, the Commission has to determine whether the proposed variation would produce at least the same level of public benefits as exists under the current determination. If a reduced level of public benefits will result, the application should be rejected.

7.4 Although the task of the Commission is to determine the overall effect of the proposal in terms of public benefit it is convenient to set out the Commission's consideration of public benefit using the structure of paragraph 5 of the Policy Statement. In practice, each element of public benefit impacts on the others and cannot be neatly compartmentalised.

Public benefits

Tourism Benefits

*The extent to which proposals 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).*

7.5 Qantas claims that the proposal will enable it and Eva to deliver a marketable frequency of services to both Brisbane and Sydney.

7.6 The Queensland Government believes the inbound market from Taipei to Queensland will benefit considerably from the proposal. The ATC also supports the application because if Qantas remains in the market, it has more reason to work with the ATC on joint promotional campaigns.

7.7 The Commission accepts that Qantas is more likely to stay on the route if the code share application is approved and that the code share arrangements will enable both airlines to offer services to both Sydney and Brisbane. Were Qantas to withdraw from the route because code sharing was not approved, the reduction in capacity, choice of services and marketing of Australia as a tourist destination would be likely to harm Australian tourism.

7.8 In the circumstances, the Commission concludes that the proposal will have a positive impact on inbound tourism.

Consumer Benefits

The extent to which proposals 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 standard of services;*
- *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).*

7.9 Australian consumers will be able to purchase seats from Qantas on three non-stop services a week from both Sydney and Brisbane. The ability of Brisbane passengers to avail themselves of Qantas frequent flyer benefits on /Eva flights (and vice versa) will be of some benefit to Australian consumers.

7.10 The Commission recognises that, while Qantas' own operations remain unchanged, there will be a slight consumer benefit resulting from the ability of customers in Brisbane and Sydney to purchase seats on both Eva and Qantas services, on three non-stop flights per week.

7.11 The Commission concludes that the impact on consumers of the proposal is marginally positive.

Trade Benefits

The extent to which proposals will promote international trade. The Commission should have regard to:

- *the availability of frequent, low cost, reliable freight services for Australian exporters and importers.*

7.12 As there will be no change in the availability of freight capacity, the Commission concludes that the impact on trade of the proposal would be neutral.

Competition Benefits

The extent to which proposals will contribute to the development of a competitive environment for the provision of international air services. The Commission should have regard to:

- *the need to develop strong Australian carriers capable of competing effectively with one another and the airlines of foreign countries;*
- *the number of Australian carriers using capacity on a particular route and the existing distribution of capacity.*
- *the extent to which applications are proposing to provide capacity on aircraft they will operate themselves as, in the long term, operation of capacity on own aircraft is likely to result in more competitive outcomes;*
- *the provisions of any commercial agreement between an applicant and another airline affecting services on the route but only to the extent of determining comparative competition benefit between competing proposals;*
- *any determinations made by the Australian Competition and Consumer Commission or the Australian Competition Tribunal in relation to a carrier operating or proposing to operate on all or part of the route; and*
- *any decisions on notifications made by the Australian Competition and Consumer Commission in relation to a carrier operating or proposing to operate on all or part of the route.*

7.13 The ACCC is concerned about the potential for competition to be lessened given that Eva and Qantas are the major providers of direct capacity on the route.

7.14 The Commission recognises the potential for anti-competitive behaviour when joint services arrangements are implemented by carriers with significant market shares. The Commission notes, however, the significant presence of other carriers in the Australia-Taiwan market. In 1999, China Airlines had 13% of the market and Air New Zealand (code sharing on Eva) nearly 4%. Sixth freedom airlines carried approximately 28% of Australia-Taiwan passenger traffic in 1999, with Cathay Pacific carrying 16% of the traffic (a higher share than that of China Airlines) and Singapore Airlines 9%. With Ansett International's withdrawal from the market (with a 17% share), it is reasonable to assume that there will be keen competition to capture its traffic.

7.15 The Commission considers that the significant presence of other carriers, in particular sixth freedom carriers, in the market mitigates the market power of Qantas and Eva.

7.16 Another countervailing pressure to the market power of the direct carriers is the strong fares competition on routes from Taiwan to destinations such as the US and Europe. These destinations compete with Australia in Taiwan's tourism market. The ATC has advised that fares from Taiwan to the US and Europe are very similar to fares to Australia. As noted above, most Taiwan passengers in the Australian market travel for leisure purposes and are therefore likely to be price sensitive and low yield.

7.17 The Commission also notes that there are significant amounts of unused capacity for carriers of both Taiwan and Australia. If passenger fares were to rise significantly following the commencement of joint services between Qantas and Eva, other carriers, such as Ansett International and China Airlines, would have the opportunity to enter the market or increase capacity.

7.18 The proposal entails a reciprocal blocked space arrangement, which does not involve any financial payments. The Commission agrees with Qantas that both airlines have a strong incentive to sell the seats they are marketing, since there are no handback provisions in the agreement and they forego revenue if they do not sell their seats on the other carrier.

7.19 The Commission concludes that the competition benefits of the proposed code share arrangements are neutral. However, to the extent that approval of the application helps Qantas remain on the route, the Commission considers that the code share would have a positive impact on competition.

Industry Structure

The extent to which proposals will impact positively on the Australian aviation industry.

7.20 In answer to the ACCC's question about features of the code share that will allow it to stay in the market, Qantas says that the code share will enable it to secure a larger number of passengers and revenue on the Taiwan route than would be possible with discrete operations to Sydney and no non-stop service to Brisbane. Qantas will also be able to make significant cost savings by replacing the current multi-sector operation with the proposed arrangements.

7.21 The Commission concludes that there will be industry benefits because the viability of Qantas' Taiwan service should be improved.

Conclusion

7.22 The Commission concludes that the code share proposal will be of benefit to the public and will approve the application.

8 Decision ([2000] IASC 204)

8.1 In accordance with section 24(1) of the Act, the Commission varies Determination IASC/DET/9912 by permitting Qantas Ltd (Qantas) to operate services jointly with Eva Air (Eva) on flights operated by Qantas between Sydney and Taipei, consistent with the summary of the Qantas/Eva code share agreement presented to the Commission, subject to the following conditions:

- the finalised code share agreement, signed by Qantas and Eva, must be approved by the Commission, prior to the code share services commencing;
- any amendments to the code share agreement must be approved by the Commission;
- any new code share agreement must be approved by the Commission;
- Qantas must price and sell its services on the route independently;
- Qantas must not share or pool revenues under any such agreement; and
- Qantas must take all reasonable steps to ensure that all passengers are informed, at the time of ticket reservation, of the carrier actually operating the flight.

Dated: 19 April 2000

Michael Lawriwsky
Member

Stephen Lonergan
Member