

DECISION

DECISION: [2000] IASC 217
VARIATION OF: IASC/DET/9615, 9618, 9810 AND 2000/107
THE ROUTE: SOUTH AFRICA
THE APPLICANT: QANTAS AIRWAYS LIMITED
(ACN 009 661 901)
PUBLIC REGISTER FILES: IASC/APP/200026

1 The application

1.1 Qantas Airways Ltd (Qantas) applied to the Commission on 16 October 2000 to vary IASC Determinations 9615, 9618, 9810, and 2000/107 to permit South African Airlines (SAA) to code share on Qantas operated flights between Australia and South Africa. Qantas has proposed that the variation apply for the duration of the Determinations. Under the proposal Qantas will operate five non-stop Sydney-Johannesburg services per week with SAA code sharing on these services, and SAA will operate five Johannesburg-Perth services with Qantas code sharing on these SAA services.

1.2 The Qantas code share on the flights operated by SAA requires no action by the Commission.

1.3 On 20 October 2000, the Commission published a notice inviting submissions from interested parties about the application. Submissions were received from Ansett International, dated 6 November, and the Australian Competition and Consumer Commission (ACCC), dated 10 November. In response to requests by the Commission, additional confidential information was received from Qantas in letters dated 27 and 31 October and 14 and 20 November. Qantas made a further, non-confidential submission supporting its public benefit claims in a letter dated 14 November.

1.4 On 23 November 2000 the Commission published a draft decision proposing to approve the application, subject to a number of conditions in addition to those it normally imposes. The only respondent to the Draft Decision was Qantas in a submission dated 5 December 2000. The Draft Decision and the Qantas response are discussed in paragraph 7 below.

1.5 All non-confidential material supplied by the applicant and submitters is filed on the Register of Public Documents. All confidential material is filed on the Commission's confidential register.

2 Current services

2.1 Currently, Qantas and SAA operate on the South Africa route. Both Qantas and SAA operate four B747 services per week on a Sydney–Perth–Johannesburg routing.

2.2 Indirect services between Australia and South Africa are provided by third country carriers, most notably Singapore Airlines (via Singapore), Malaysian Airlines (via Kuala Lumpur) and Cathay Pacific (via Hong Kong).

3 Characteristics of the Australia- South Africa route

3.1 In the year ended 30 June 2000, traffic on the Australia – South Africa route totalled approximately 242,300 passenger movements. Of these passenger movements, 54.3% were passengers with a destination of either Australia or South Africa travelling directly between the countries (direct traffic). Some 26.2% of movements involved passengers travelling indirectly between the two countries (indirect traffic). The remaining 19.5% of the movements involved passengers travelling directly between Australia and South Africa to and from countries beyond South Africa or Australia (beyond traffic).

3.2 Direct traffic increased by 4.0% in the year ending June 2000, compared with an increase of 22.8% in the year ending June 1999. Indirect traffic fell by 10.7% in the year ending June 2000 after having increased by 27.6% in the previous year. Beyond traffic has held steady over the past two years.

**Australia – South Africa Passenger Movements
Years Ended 30 June 1997 – 30 June 2000**

| Traffic category | Year ended June | | | | Compound annual growth rate 97-00 |
|--|-----------------|----------------------------|-----------------------------|----------------------------|-----------------------------------|
| | 1997 | 1998 | 1999 | 2000 | |
| Direct traffic (Annual % change) | 95,200 | 103,000 (+8.2%) | 126,500 (+22.8%) | 131,500 (+4.0%) | (54.3%) 11.4% |
| Indirect traffic (Annual % change) | 56,500 | 55,700 (-1.4%) | 71,100 (+27.6%) | 63,500 (-10.7%) | (26.2%) 4.0% |
| Beyond traffic (Annual % change) | 40,600 | 47,100 (+16.0%) | 46,800 (-0.6%) | 47,200 (+0.9%) | (19.5%) 5.1% |
| Total traffic (Annual % change) | 192,300 | 205,900 (+7.1%) | 244,400 (+18.7%) | 242,300 (-0.9%) | (100.0%) 8.0% |

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 30 June 2000, South African residents comprised 65% of the passenger traffic with origin/destination South Africa. South African residents visiting Australia did so mainly for holiday (39.4%), visiting relatives (31.0%) and for business

(13.3%). Australians visiting South Africa had a similar journey purpose profile with holiday (33.8%) being the main reason followed by visiting relatives (30.5%) and for business (20.2%).

3.4 The table below shows that Qantas' market share on the South Africa route has declined a little over recent years, while South African Airways has improved market share at the expense of all other carriers.

Australia – South Africa Origin Destination Traffic by Airline

| Year ended June | 1997 | 1998 | 1999 | 2000 |
|-----------------------|------|------|------|------|
| Qantas Airways | 43.7 | 41.5 | 41.7 | 39.1 |
| South African Airways | 24.8 | 28.5 | 27.0 | 32.5 |
| Singapore Airlines | 9.9 | 11.1 | 11.3 | 10.1 |
| Malaysian Airlines | 10.2 | 9.2 | 10.1 | 8.8 |
| Other | 11.4 | 9.7 | 9.8 | 9.6 |

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

3.5 In the year ending June 2000, 42.8% of the origin destination traffic on the route indicated that New South Wales was their state of residence or state of intended longest stay, Western Australia followed with 22.4% and then Queensland and Victoria each having 14.2%.

4 Provisions of relevant air services arrangements

4.1 The Australia-South Africa air services arrangements allow designated airlines of the two countries to code share on each other, but not on the services of an airline of a third country. Qantas does not require the Commission's approval to code share on SAA's services as the marketing carrier's seats do not involve the use of capacity entitlements.

4.2 These arrangements would enable Qantas to operate non-stop flights between Sydney and South Africa whether or not in conjunction with services via Perth.

5 Applicant's proposal

5.1 With effect from 15 January 2001, Qantas plans to introduce a fifth service. SAA also plans to increase its services to five a week. Under the proposal Qantas will operate non-stop Sydney-Johannesburg with SAA code sharing on these services, and SAA will operate Johannesburg-Perth with Qantas code sharing on the SAA services. This means that Qantas will cease operations to Perth and SAA will cease to operate to Sydney.

5.2 In addition, both airlines plan to code share on the operating airline's connecting domestic and regional routes. This does not require the Commission's approval.

5.3 Qantas claims that the code share is structured to ensure the maintenance of a competitive environment on the Australia-South Africa route. Qantas and SAA, as marketing carriers, will pay a fixed amount for a set block of seats (40% of the aircraft's

capacity) to the operating carrier on each service operated. Qantas states that the arrangement does not include a hand back facility and each carrier will be exposed to losses if seat block costs are not covered (“a hard block” arrangement). All seats will be priced and sold independently. Qantas and SAA also propose to enter into a special prorate agreement to make available lower priced Qantas domestic fares to SAA passengers connecting to/from SAA services at Perth and SAA’s “hard block” capacity on Qantas services at Sydney.

5.4 Qantas states that the South Africa market has softened to the point where it is no longer profitable for Qantas and shows no prospect for improvement unless changes are made to the current pattern of services. Qantas attributes its poor performance on the route to a downturn in traffic, capacity increases and loss of market share attended by an unbroken decline in yield and rises in operating costs. Qantas has also had difficulty in maintaining three class B747s on the route due to the availability of aircraft, thus restricting its ability to optimise the mix of higher yielding passengers necessary for profitable operations.

5.5 Qantas lists three possible options for dealing with this situation:

- 1) scale back, either by reducing frequency and/or omitting Perth
- 2) withdraw from the market totally
- 3) increase frequency of service and establish a commercial relationship with SAA.

5.6 Qantas considers the first two options to be unsatisfactory from a consumer and market perspective. In its view, neither would produce the financial result that the third option of a code share arrangement with SAA would bring.

Submissions in relation to the proposal

5.7 In its submission Ansett International states that the cooperative arrangements between Qantas and SAA will have a clear commercial impact on the Ansett Air New Zealand group, as SAA is currently a significant revenue source for the group. Also, over 28% of Australia-South Africa traffic travels on third country carriers, most notably Ansett’s alliance partner, Singapore Airlines.

5.8 Ansett International points out that the current air services arrangements do not permit code sharing with third country carriers and also that there is no capacity available. Ansett International is not opposed to the proposed code share per se. However, as the air services arrangements currently do not allow it to make a competitive response, which is particularly important as it stands to lose revenue as a result of the code share, Ansett International considers that approval should not be granted until liberalisation of the air services arrangements occurs.

5.9 In its submission, the ACCC points out that in providing comments, it cannot have regard to the extent to which any perceived anti-competitive aspects are offset by

claimed benefits. The ACCC only examines such benefit claims pursuant to applications for authorisation or notification under Part VII of the Trade Practices Act.

5.10 The ACCC states that it does have concerns. Qantas and SAA are the only two direct operators on the route and together have a 70% share of the market. There is competition from indirect carriers, but this is less attractive in terms of travelling time. The proposed code share will further advantage the direct carriers and is likely to see them increase their market share and influence on the route.

5.11 The code share would be less likely to impact on competition if there were no substantial barriers to entry. However, there is no capacity available and there are no provisions for third country carrier code sharing under the bilateral arrangements. Even if there were, it would be difficult for a new entrant to compete against an established alliance with 10 services a week to Perth and Sydney.

5.12 Notwithstanding the purported “hard block” arrangements, the ACCC considers that there must be doubts over whether there would be effective price competition between Qantas and SAA. It is unlikely that the carriers would compete to the extent that they would capture market share from each other when it is in their mutual interest that the other party is viable and available to hold up its part of the arrangement. In the ACCC’s view the arrangement is more likely to see prices converge, subject to the limited price competition pressures from indirect carriers. Also, in the absence of strong competition, the ACCC considers that it is questionable whether claimed cost savings would be passed on to consumers.

5.13 The ACCC suggests that in the absence of code sharing Qantas may well have contemplated introducing “through” (non stop) services to Sydney and SAA would have had to make a competitive response, for example operating Perth/Melbourne.

5.14 The ACCC considers that, on the basis of the information provided by Qantas, the proposed code share is at risk of being in breach of the Trade Practices Act. It states that it would give consideration to pursuing more detailed investigations of the arrangements pursuant to the anti-competitive agreement provisions of the Trade Practices Act in the event that the IASC approves the application.

Public benefits claimed by Qantas

5.15 In its submission of 14 November, Qantas detailed the benefits to the public that it expects to arise from the code share proposal. These are, in summary:

- The code share will allow the carriers to reverse the decline in route profitability while at the same time offering improved services for consumers, tourists and Australia’s aviation industry.
- Without the code share, continued losses would force Qantas to reconsider its frequency of operations to Sydney and Perth, with the possibility of withdrawing from Perth altogether.

Tourism benefits

- Qantas has been active in marketing its services, and “destination Australia”, in South Africa and the wider African market for many years. Maximising the frequency of flights and providing all non-stop services to both Sydney and Perth will enhance the tourism product.
- The network diversity and better connection times to and from domestic and regional destinations provided by the code share will also improve the tourism product.
- A further increase in Qantas participation in the South Africa market is expected to result in a higher level of inbound tourism.

Benefits to Australian consumers

- The code share will increase marketed services from 8 to 20 per a week on a cost effective basis.
- Consumers will benefit from the cost savings that more efficient use of resources generates and from the prorate agreement which will enable each carrier to offer competitive fares.
- In addition to improved efficiencies, the code share will increase the total seats available, increase the coverage of preferred days of the week, and provide improved travelling times and connections.
- Sydney to Johannesburg travel time will be reduced from 17 to 14 hours and for the return trip from 14 to 12 hours, compared with 22 and 25 hours via Singapore and Malaysia.
- Domestic services from Sydney connecting with SAA’s Perth service on the two days that Qantas does not operate non-stop will give Sydney passengers a daily service to South Africa.
- Dropping the expensive and inefficient Sydney extension will reduce SAA’s costs in a way which will allow considerable leeway to aggressively market both their Sydney code share and Perth operated capacity.
- The code share will provide improved connections to South African domestic and regional African destinations and ensure that Qantas maintains its presence in the Harare market.
- The commercial agreement will encourage Qantas and SAA to cooperate in a number of customer service areas.
- Consumers will benefit from maintenance of a three class service.

- Through check-in service will be provided.
- Qantas and SAA passengers will benefit from joint use of lounge facilities and joint award/redemption of frequent flyer points.

Trade benefits

- While the code share will not extend to cargo, direct services from Sydney and Perth will benefit exporters and trade forwarders, particularly for time sensitive cargo.
- The irregular availability of space on SAA's services between Perth and Sydney will be replaced by an improved level of wide bodied domestic Qantas services every day.

Impact on the Australian aviation industry

- The code share will provide Qantas with a more efficient and financially sound means of offering a daily service on the South Africa route.
- The code share will return the route to viability.

Competition benefits

- The code share will enable Qantas to continue to be a viable, competitive force in the Australia-South Africa market.
- Ten foreign carriers have unrestricted traffic rights between Australia and South Africa and therefore have the opportunity to introduce further competing services.
- Importantly, the code share agreement has been structured to ensure that Qantas and SAA continue to compete aggressively on the route.
- There will be no agreement for the handback of seats to the operating carrier meaning that both airlines will be fully committed to "last seat sale" on each flight operated.
- Should either carrier fail to sell sufficient seats to cover its own fixed costs (whether marketing or operating) it will incur a loss on the flight concerned.
- In addition to the competition benefits on the trunk route, the proposal will improve the ability of the carriers to compete regionally at each end of the route.

6 Commission's assessment

6.1 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.

6.2 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 two submissions in this instance, one which raised competition concerns and the other which opposed approval of the application until the air services arrangements with South Africa are renegotiated. 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.

6.3 In relation to the paragraph 5 criteria, the Commission has to decide whether the variation sought to the determination would be of benefit to the public. As the Commission has stated previously, it does not see this as requiring a finding that the variation will provide additional benefits. Rather, the Commission's task is to decide 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, then the application should be rejected.

6.4 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.

Assessment against the paragraph 5 criteria

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).*

6.5 The Commission notes that the total number of services and seats operated by Qantas and SAA to Australia will increase under the proposal. Also, non-stop services and reduced travel times should make the proposed services more attractive to tourists travelling to Sydney and other East Coast destinations. In addition, better domestic and regional connections should further enhance opportunities for travellers.

6.6 Although under the proposal the number of services overall will increase, the number of operated services each to Sydney and Perth will fall from eight to five a week (with the coverage of days of the week remaining the same) and the choice of operating carrier providing direct services to both ports will be reduced from two to one. While in the case of Sydney the Commission considers that the loss of tourism benefits resulting from this is more than offset by the introduction of a non-stop and faster services, there would appear to be a net reduction in benefits for Perth. Nonetheless, there will be an increase in the number of seats dedicated to Perth and Qantas will continue to market and sell tickets to Perth as a tourist destination. Also, the prorate agreement with Qantas for domestic add ons should enable SAA to offer attractive fares to tourists beyond Perth to other destinations in Australia, including to the East Coast.

6.7 Qantas states that it has been marketing its services in the South African and wider African market for many years and that an increased participation in the market (through marketing a greater number of frequencies and destinations) will result in a higher level of inbound tourism. The Commission accepts that there will be some benefits.

6.8 The extent to which there will be a tourism benefit will depend to a very large extent on whether Qantas and SAA compete on price with each other and with the indirect carriers in the price-sensitive segment of the market. At the same time the Commission has to consider the consequences for tourism, as for the other public benefit criteria in paragraph 5, if the proposal is not approved. Qantas has indicated that it and SAA would not increase their frequencies and may reduce them without the code share. Were this to be the case, fewer services and less active marketing of Australia as a tourist destination would be likely to harm Australian tourism. Further, Qantas might choose to serve South Africa exclusively with direct flights to/from Sydney to the detriment of WA tourism.

6.9 In the circumstances, the Commission concludes that on balance, there would be a net benefit to tourism, but this benefit is confined to the East Coast Australia where the largest proportion of traffic originates/terminates and only if competitive pressures on prices are maintained.

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).*

6.10 In the Commission's view it is necessary to separate the business and leisure markets in evaluating consumer benefits. For the time sensitive business market a non stop service provides substantial public benefit. However it should be noted that there is a reduction in the number of services and choice of operating carrier from both Perth and Sydney.

6.11 The benefits for the business sector of the Perth market which already enjoys direct services will be reduced through fewer frequencies and less choice of airline. On the other hand there should be more business class seats available to the Perth market.

6.12 A non stop service out of Sydney is clearly a benefit for the consumer. However, the Commission is concerned that because indirect carriers cannot offer a comparable service, there will be little competitive pressure on prices for time sensitive travellers unless Qantas and SAA actively compete with each other. If this does not occur, there could be a steady rise in business class fares in spite of cost savings.

6.13 The Commission considers that there is more scope for the indirect carriers to compete in the leisure market, where passengers are more likely to be prepared to trade off longer journey times for a lower fare.

6.14 There would be some marginal benefits for consumers, and in particular for regular travellers on the route (most likely to be business), from the joint use of lounge facilities and joint award/redemption of frequent flyer benefits. However these benefits would also be available by arrangements other than code share.

6.15 As discussed under Tourism Benefits above, any scaling back in the level of services that might result from a rejection of the application would be detrimental to the consumer.

6.16 The Commission concludes that, provided there is genuine competition on fares, the impact on consumers of the proposal overall should be 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.*

6.17 There would be fewer services to Sydney and Perth, but overall an increase in total bellyhold cargo space available, with five dedicated services a week each to Perth and Sydney. However, the Commission agrees with the ACCC that there would no longer be competition between Qantas and SAA on freight services or rates. The Commission also

notes that other than for perishable/time sensitive freight, indirect carriers should continue to provide competition in the Australia - South Africa air freight market.

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.*

6.18 The Commission considers that the code share proposal should help Qantas return to profitability on the route and therefore make it a stronger competitor in the Australia - South Africa market.

6.19 Qantas and SAA will be increasing capacity in what appears to be a softening market, at least in the short term. They may be able to fill some of the extra seats by generating new traffic through offering a more attractive service and keeping fares low through cost savings. It is quite possible, however, that Qantas and SAA will rely more on diverting traffic from the sixth freedom carriers, thus increasing their already high market shares.

6.20 The Commission recognises the potential for anti-competitive behaviour when joint services arrangements are implemented by carriers with significant market shares. Currently, Qantas and SAA together have 72% of the market, with the remaining 28% of Australia-South Africa traffic carried by sixth freedom carriers, principally Singapore Airlines and MAS with about 10% each. As the ACCC points out the routes offered by the indirect carriers are less attractive in terms of travelling time and these carriers have not been able to increase their market share over the last five years.

6.21 The ability of Qantas to operate faster, non-stop services to Sydney, and of both Qantas and SAA to significantly reduce costs by each dropping one point, will make them even more competitive with sixth freedom carriers. Qantas claims that the cost savings will help them return to profitability without raising fares. The ACCC questioned whether, in the absence of any direct or strong indirect competition, savings would be passed on to consumers.

6.22 The Commission considers that there would continue to be scope for indirect carriers to compete for the leisure market for which price is usually more important than time, although obviously they would need to be able to offer very attractive fares in order to offset the advantages that the direct carriers would have. Of greater concern to the Commission is the possibility that reduced competitive pressures from sixth freedom carriers for business traffic could see fares rise steadily in this segment of the market. The only circumstance in which this is not likely to occur is if there is genuine competition between the code share partners. Accordingly, the Commission attaches particular importance to the nature of the commercial relationship between the joint service partners.

6.23 Qantas states that the arrangement is a “hard block” space arrangement with no hand back facility, and that each carrier will be exposed to losses if seat block costs are not covered. If this is the case, and taken together with the additional seats that the two airlines plan to put into what appears to be a softening market, there should be a strong incentive for both airlines to compete on price in order to sell their code share seats.

6.24 Because this issue is so crucial on a route where it is clearly difficult for the indirect carriers to compete for the key time sensitive market, the Commission has gone to some lengths in confidential correspondence with Qantas to assess the potential of the proposal to reduce competition between the code share partners. While it is impossible to be sure before the proposal is implemented, the Commission is reasonably satisfied that the carriers’ arrangements will maintain scope for competition.

6.25 Both the ACCC and Ansett International have expressed concern about the regulatory barriers to entry on the route. There is no available capacity or provision for third country carrier code sharing on the route. The Commission shares this concern, but notes from the Ansett International submission that the Australian Government has proposed a package of reforms that if agreed would address these issues. Liberalisation of the air services arrangements would obviously open up opportunities for more competition on the route. Unless this competition were in the form of direct services, however, it is unlikely that it would add significantly to competitive pressure on the incumbent carriers. The Commission understands that there are few regulatory impediments to sixth freedom carriers increasing their presence in the market and notes that Singapore Airlines, for instance, already operates six services a week to Johannesburg.

6.26 The Commission accepts that the code share proposal is structured specifically to address competition concerns. Nonetheless, it considers that inevitably when two carriers which were previously competitors enter into a cooperative arrangement there is the potential for a lessening of competition, and in particular on a route where there is

already a high degree of market concentration. Accordingly, the Commission concludes that the proposal, in its present form, would be likely to result in a lessening of competition.

Industry Structure

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

6.27 The proposal should enable Qantas to strengthen its position in the Australia-South Africa market by being able to offer a faster, non-stop service between Sydney and Johannesburg, while maintaining a presence in Perth. Qantas will also achieve cost savings by ceasing to operate via Perth. On the other hand, the proposal may have a negative impact on Ansett's domestic operations which states that it expects to lose revenue as a result of these arrangements.

6.28 The Commission concludes that aviation industry benefits would be marginally positive.

Conclusion

6.29 An important issue for the Commission to address is the effect of rejection of the application. Qantas has said that absent the code share, continued losses of the current magnitude could lead to the withdrawal of Qantas from the Perth - Johannesburg market and would mean no increase in services to Sydney. It says SAA may be placed in a similar situation of having to review its operations in the face of its own continuing losses.

6.30 While it is not possible to come to any firm conclusions on the likely scale of reductions were the application to be rejected, the Commission accepts that in the current environment Qantas is not likely to proceed with capacity increases and may have difficulty in maintaining current levels of operation.

6.31 The Commission concludes that the public benefits offered by these arrangements marginally outweigh the detriments, particularly some lessening of competition.

7 Draft Decision

7.1 To ensure that the competitive basis on which the application has been predicated and assessed is maintained, particularly as to the increase in services and the “hard block” seat sale arrangements, the Commission proposed in its Draft Decision a number of conditions in addition to those it normally imposes.

7.2 The first condition was that the code share approval would automatically lapse if the combined number of scheduled services by the code share partners, Qantas and SAA, fell below 10 services a week (it would be automatically reactivated, without reference to the Commission, were the level of services to return to at least 10 per week). The second was that the two carriers should withdraw from all IATA tariff coordination activities in relation to air fare levels between Australia and South Africa. The third was that Qantas must report quarterly on the number of code share seats sold by each marketing carrier on the services of the operating carrier.

7.3 The Commission also proposed to approve the application for a limited time, up to the end of the 2001 Northern Summer scheduling period so that it could assess the arrangements in the light of market experience, particularly as to trends in the level of fares and freight rates.

7.4 The Commission published a notice on 29 November 2000 inviting comments on its Draft Decision. The only submission received was from Qantas, dated 5 December 2000.

The Qantas submission and the Commission’s response

7.5 In its submission Qantas sought amendments to some of the proposed conditions, claiming that in their proposed form they could impede Qantas and SAA from implementing the code share on a commercially sustainable basis.

7.6 With regard to the proposed condition that the code share would lapse if the combined number of services fell below 10 per week, Qantas seeks some flexibility to allow the airlines to reduce services during periods of low demand. Qantas says that because of the seasonality of the route SAA in particular would be exposed to this aspect of the Draft Decision, given the relatively small size and the traffic composition of the Perth-South Africa market. Ten services a week equates to 520 round trips per annum (260 for each airline operating five services a week). The Qantas proposal is that Qantas be able to reduce its services by a maximum of 10 per annum and SAA by 25 per annum.

7.7 The Commission accepts that at times the seasonal nature of the route (particularly the Perth-Johannesburg sector) may make five services a week uneconomic and therefore the Commission will agree to this amendment, given that at worst it would allow Qantas to reduce capacity by some four per cent and SAA by some 10 per cent. The linkage of the approval to 10 services a week will otherwise remain, with the

proviso that the number of services now specified in the Decision is the minimum that must be operated to meet this condition.

7.8 With regard to the duration of the approval, Qantas suggests approval to the end of June 2002, arguing that a longer period of approval would provide more reliable data for the Commission's review, a sounder environment for SAA's commercial decision to withdraw from the Sydney market and greater certainty for selling into the 2001/02 peak season.

7.9 The Commission considers it is important as part of the monitoring and review process that its approval be of limited duration. Nonetheless, the Qantas proposal will enable the Commission to better assess the impact of the code share on competition over a whole year, including the southern summer peak when upward pressure on fares could be greatest, and give it time to arrive at a decision on renewal well in advance of the expiry date. Prior to June 2002, IASC Determination IASC/DET/9615 allocating capacity to Qantas on the South Africa route is due for renewal and this can provide an opportunity for a review before June 2002 if circumstances require. The Commission therefore accepts the Qantas proposal.

8 Role of the ACCC

8.1 The Commission notes the ACCC's concerns in respect of this application. One option considered by the Commission was to defer a decision on this application until ACCC and Qantas had by authorisation or otherwise resolved the Trade Practices Act issues involved in this proposal. This course was not adopted because it was felt that the most efficient way of coordinating the different functions of the IASC and the ACCC was to first provide Qantas with a decision on its application.

8.2 The Policy Statement and its associated Explanatory Memorandum 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.

9 Decision ([2000] IASC 217)

9.1 In accordance with section 24(1) of the Act, the Commission varies Determinations 9615, 9618, 9810, and 2000/107 to permit SAA to code share on Qantas flights operated to and from South Africa from 15 January 2001 until 30 June 2002, consistent with the draft Qantas/SAA code share and commercial agreements provided to the Commission, subject to the following conditions:

- the finalised code share and commercial agreements, signed by Qantas and SAA, must be approved by the Commission, prior to the code share services commencing;
- any amendments to the code share agreement, 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 price and sell its services on the route independently;
- Qantas must not share or pool revenues under any such agreement;
- 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;
- the approval will only be effective while Qantas and SAA together operate at least 10 services per week on the route or, allowing for the possibility of some reduction in services during periods of low demand, no less than 250 round trip services per annum for Qantas (excluding supplementary services) and no less than 235 round trip services per annum for SAA (excluding supplementary services), with effect from 15 January 2001;
- Qantas and SAA withdraw from all IATA tariff coordination activities in relation to air fare levels between Australia and South Africa; and
- Qantas must submit to the Commission reports each quarter on the number of code share seats sold by it on each of SAA's operated services and by SAA on each of Qantas' operated services.

Dated: 11 December 2000

Ross Jones
Chairman

Michael Lawriwsky
Member

Stephen Lonergan
Member