DECISION

DECISION:	**[2003] IASC 204**
VARIATION OF:	**IASC/DET/9810, 2000/107, 2001/114 AND 2002/117**
THE ROUTE:	**SOUTH AFRICA**
THE APPLICANT:	**QANTAS AIRWAYS LIMITED (ACN 009 661 901)**
PUBLIC REGISTER FILES:	**IASC/APP/200305**

1 The application

1.1 Qantas Airways Ltd (Qantas) applied to the Commission on 16 April 2003 to vary IASC Determinations 9810, 2000/107, 2001/114 and 2002/117 to permit South African Airlines (SAA) to continue code sharing on Qantas services between Australia and South Africa for a further two years from 1 July 2003 until 30 June 2005. Qantas concurrently sought the renewal of Determination IASC/DET/9810, as this expires on 21 October 2003. The Commission first authorised code sharing pursuant to these determinations in Decision [2000] IASC 217 of 11 December 2000. It extended the duration of the approval to 30 June 2003 in Decision [2002] IASC 212 of 22 April 2002. Qantas advised that the conditions attached to the current code sharing authorisation are acceptable and that it was not seeking any change to them.

1.2 On 16 April 2003, the Commission published a notice inviting submissions from interested parties about the application. No submissions were received. In response to a written request by the Commission for information relating to the economic and financial performance of operations on the South Africa route, a detailed confidential submission was received from Qantas in a letter dated 21 May 2003.

1.3 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 and planned services

2.1 Currently, Qantas and SAA each operate four B747 services per week between Australia and South Africa. Qantas operates on a Sydney–Johannesburg routing, with SAA flying between Johannesburg and Perth.

2.2 Qantas plans to add a fifth weekly service from October 2003. This will bring its total seats operated to 2,122 per week from the current 1,690 per week. The SAA code share seat allocation will rise to 795 per week from 636 per week (maintaining 159 seats per flight). Qantas advised that SAA plans to introduce a fifth weekly service from 31 August 2003, at which time it would introduce A340-200 aircraft to operate all services, replacing the B747s. The lesser capacity of the A340 means that total seats operated with the five services would rise only to 1,180 from the currently flown 1,164 seats.

Qantas' code share seat allocation would stay much the same (470 seats compared with 468 seats now), except during the Rugby World Cup period when the number of seats would rise to 665 per week as SAA temporarily substitutes larger capacity B747-300 aircraft for the A340.

2.3 Indirect services between Australia and South Africa are provided by third country carriers, principally Singapore Airlines (via Singapore), Malaysian Airlines (via Kuala Lumpur), Cathay Pacific (via Hong Kong) and Emirates (via Dubai).

3 Provisions of relevant air services arrangements

3.1 The Australia-South Africa air services arrangements allow the designated airlines of each country to code share on each other's services. 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 bilateral capacity entitlements.

4 Applicant's proposal

4.1 Qantas advised that all of the conditions specific to the Commission's authorisation of code sharing had been met by itself and SAA. Central amongst these conditions were that:

- Qantas and SAA were required to operate at least eight services per week between them, although they were able to reduce frequency in the event of unforeseen circumstances or unexpectedly low demand;

- the two airlines were to withdraw from all IATA tariff co-ordination activities relating to fare levels between Australia and South Africa; and

- Qantas was to price and sell its capacity independently of SAA.

4.2 Qantas and SAA have maintained frequency levels on the South Africa route, as demand has been relatively unaffected by the Iraq conflict and the SARS virus. This contrasts with many other routes where there have been significant temporary capacity reductions. Qantas' plans for capacity expansion are summarised in section 2 above. The Rugby World Cup events in Australia in October and November are expected to provide a boost to demand. Qantas advises that SAA plans to continue indefinitely with five services per week from 31 August 2003. Qantas plans to continue with five weekly services until the end of January 2004, and will review the situation nearer the time. Given the current uncertain operating environment, Qantas has given no guarantees about future schedules.

4.3 Qantas wishes to continue indefinitely its code share arrangements with SAA, advising that it has no plans to re-route its Sydney services via Perth, but wishes to continue participating in the Perth-Johannesburg market by code sharing on SAA's services. Similarly, Qantas understands that SAA has no plans to alter its service patterns from Perth only.

4.4 Qantas advised that the South African Competition Commission renewed its authorisation of the code share arrangement for the period to 18 December 2005. Qantas is seeking an extension of authorisation from the IASC until 30 June 2005. Qantas is not seeking to extend the code share to cargo carriage, with both Qantas and SAA continuing to control their own operated cargo capacity.

4.5 Qantas outlined what it considers to be the benefits of the code share arrangement. The code share has allowed both Qantas and SAA to restructure services, reducing operating costs and enabling both carriers to maintain a market presence on the Sydney – Johannesburg and Perth – Johannesburg city pairs. As a result, the public has benefited in a range of ways. These include maintenance of competition between Qantas and SAA, an attractive frequency of non-stop services to Sydney, convenient timings and connections for New Zealand and domestic transfer passengers, and the continuation of a Qantas presence in the West Australia – South Africa market. The improved financial basis for operations resulting from the code share will assist the two airlines to improve services, in terms of increased frequency and newer aircraft (in the case of SAA). Withdrawal of code share authority would be likely to have negative implications, particularly for the level of capacity and frequency to Perth.

5 Commission's assessment

5.1 Under section 15(2)(e) of the Act, a carrier cannot use allocated capacity to provide joint services with any other carrier without the prior approval of the Commission.

5.2 In its original decision in December 2000 to authorise code sharing between Qantas and SAA, the Commission found that the public benefits from authorisation were likely to marginally outweigh the detrimental effects that might arise. An important factor in deciding to allow the code share was the Commission's concern that rejection of the application may have a detrimental impact on the level of services between Perth and Johannesburg.

5.3 When reviewing the situation again in April 2002 (Decision [2002] IASC 212), the Commission was able to analyse actual economic and financial data from the operation of the code share. This enabled the Commission to obtain an in-depth insight into the commercial viability of the services on the route for Qantas, relative to the hypothetical situation before the code share commenced. The Commission also had a clearer basis on which to assess the likely operational outcome if the code share authorisation was to be withdrawn. At that time, the Commission found that the code share arrangement was probably, on balance, delivering a level of public benefits consistent with its expectations in approving the code sharing.

5.4 However, the Commission was unable to reach this conclusion with great certainty, because of the confounding effects of the events of 11 September 2001. Those events led to a sharp drop in demand in the latter part of 2001 and into 2002. This in turn affected the amount of capacity in the market and the level of air fares.

5.5 The Commission was hoping to be in a position at the current review point to analyse the code share against a more normal economic background and the current situation on the route could be considered more "normal" than was the case at the 2002 review. However, this is not entirely the case, with the impact of the Iraq war and more recently the SARS virus affecting air travel demand worldwide in recent months. However, those affects have occurred relatively late in the period of the Qantas/SAA code share since the review a year ago, and Qantas has stated that the route has not been affected to the same degree as others. Nevertheless, if there has been an impact, this is likely to have lessened demand on the route (unless there has been compensating substitution of travel away from other routes). This may have affected the supply, pricing and marketing behaviour of Qantas, SAA and particularly its competitors (most of which fly through Asian ports to South Africa), relative to the situation in more normal circumstances. In turn this may have affected yields and profitability on the route to some degree.

5.6 In both of its earlier decisions, the Commission imposed conditions designed to enhance public benefits as far as possible by ensuring some degree of price competition and the maintenance of minimum frequency levels. The only substantive difference was a relaxation of the minimum weekly frequency requirement from 10 services to eight in the later decision. As noted above, Qantas has indicated in its latest application that it has no objection to these conditions. The Commission is pleased that frequencies have been maintained at the minimum levels and that both carriers have plans for increases in the near future, at least for the period into early 2004.

5.7 The Commission has carried out a detailed analysis of the route, using commercial in confidence information provided by Qantas in response to the Commission's request, as well as information available to the Commission from other sources. The approach taken has been to assess the impact of the code share arrangement on a comparable basis with the Commission's previous review in April 2002.

5.8 In summary, the Commission has found that the situation is similar to that at its previous review. Sydney services appear to continue to perform significantly better than the Perth services, although the overall situation is stronger than 12 months ago. One of the key reasons the Commission authorised the code share initially was because it was concerned that the level of Perth services may have otherwise been placed at risk. Cost savings arising from service restructuring with implementation of the code share no doubt continue to help to offset this and assisted the airlines to maintain Perth services in particular.

5.9 The Commission's continues to have concerns about the high prices facing business travellers. Qantas and SAA, the only direct carriers, have a major advantage over indirect carriers because of the much shorter travel times of the direct services. Relative travel time is a significant component in the choice of carrier for time sensitive business travellers. Even significantly lower fares offered by indirect carriers are unlikely to provide sufficient incentive for business travellers to prefer a carrier operating on an indirect routing. This situation prevailed prior to the code share commencing and is therefore not a consequence of it. The Commission cannot judge to what extent the code share has affected competition on price between Qantas and SAA for the business market, although there continues to be evidence available to the Commission that they continue to price fares differently, albeit at substantially higher levels than competitors. While impacting adversely on benefits to business travellers, higher prices for this market segment do act to support the economic viability of services to Perth, through cross-subsidising lower yielding non-business traffic.

Conclusion

5.10 The Commission concludes that the net public benefits offered by the code share arrangements continue to be positive on balance. The most significant negative issue is that prices to business travellers continue to be high and there is little incentive for the carriers to compete vigorously under a code share arrangement. On the other hand, the cost efficiencies associated with the rationalisation of services since the start of the code share has provided a basis for the continuation of services to both Perth and Sydney.

5.11 The imminent addition of a fifth frequency by both carriers will benefit the public through improved choice of day of travel and on-board improvements associated with updated aircraft operated by SAA. The additional capacity which the carriers must sell and lower aircraft direct operating costs with the A340 should act to keep prices to consumers from rising and should assist in improving profitability on the Perth – Johannesburg route in particular. The Commission continues to have concerns about the possible longer term impact of the code share if worldwide conditions for airlines improve. Qantas and SAA will be in a position to take greater advantage of their dominance of the direct market through price rises in a stronger market.

5.12 The Commission will authorise a further extension of code sharing, until 30 June 2005, and will again review the situation in detail in advance of expiry of that authorisation. At that time, the impact of the introducing of the A340 aircraft, in particular, should be apparent in the airlines' financial performance. This time frame will also bring the Commission's authorisation period fairly closely into line with that given to the code share by the South African Competition Commission. Determinations 9810, 2000/107, 2001/114 and 2002/117 will be amended accordingly. Determination 9810, which expires on 21 October 2003 will be renewed by the Commission (see separate determination) and the conditions associated with the code share will be incorporated directly into the fresh determination.

5.13 Qantas has argued that retention of the code share is important in ensuring that services are maintained. The Commission accepts that there continues to be a risk that services to Perth could suffer if the code share was not authorised, although that risk may lessen with the introduction of the more efficient A340 aircraft. If Perth services were lost or significantly reduced, there would be an erosion of public benefit. To ensure that Perth passengers continue to receive benefits from the operation of the code share, the Commission considers it reasonable to attach a condition of approval requiring the airlines to maintain a certain minimum level of services. The Commission will require Qantas and SAA to maintain the operation of a combined minimum of 2,680 seats per week. Short term flexibility will continue to be allowed in the event of seasonal demand fluctuations or if there are unforeseen operational issues. The airlines will not be permitted to reduce capacity levels on a longer term basis without first notifying the Commission.

6 Role of the ACCC

6.1 The Minister's 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.

7 Decision ([2003] IASC 204)

7.1 In accordance with section 24(1) of the Act, the Commission varies Determinations 9810, 2000/107, 2001/114 and 2002/117 to permit SAA to code share on Qantas flights operated to and from South Africa until 30 June 2005, consistent with the Qantas/SAA code share and commercial agreements 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 price and sell its 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;

- 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 remain in effect only while Qantas and SAA together operate at least 2,680 seats per week on the South Africa route, although the Commission will allow temporary reductions from this level during periods of low seasonal demand or for unforseen operational reasons, provided there is prior notification to the Commission;

- 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: 30 May 2003

Ross Jones Chairman	Michael Lawriwsky Member	Stephen Lonergan Member