



Australian Government

International Air Services Commission

DETERMINATION

Determination: [2005] IASC 103
The Route: Netherlands
The Applicants: HeavyLift Cargo Airlines Pty Ltd (ACN 102 571 746)
(HeavyLift) and Qantas Airways Ltd (ACN 009 661 901)
(Qantas)

Public Register File: IASC/APP/200502

1 The applications

1.1 On 18 January 2005, HeavyLift applied for an allocation of two weekly all-cargo services on the Netherlands route. Concurrent applications were received from HeavyLift for capacity allocations of two weekly B747 cargo services on the United States and China routes. HeavyLift's applications for capacity on those other two routes are the subject of separate determinations by the Commission.

1.2 HeavyLift's plans for the Netherlands route involve the operation of twice-weekly B747 services on a routing Sydney-Shanghai-Amsterdam. It intends to use a B747-200F (freighter) aircraft wet-leased from Kalitta Air. Kalitta Air is based in the United States and provides scheduled and on-demand charter freight services in the United States and internationally.

1.3 The aircraft then would continue from the Netherlands to the United States, operated by Kalitta Air in its own right. HeavyLift would resume operations from Los Angeles with twice-weekly services travelling from that city to Honolulu-Fiji (technical stop)-Sydney. HeavyLift plans to commence services in July 2005.

1.4 In response to HeavyLift's application, the Commission published a notice on 24 January 2005 inviting other applications for all or any part of the capacity sought by HeavyLift on the Netherlands route. A notice of intent to make a competing application for two all-cargo services per week of capacity on the route was received from Qantas on 1 February 2005. In response to this advice, the Commission wrote to Qantas inviting it to address the paragraph 5 criteria in the Minister's policy statement as part of its application. The Commission also wrote to HeavyLift inviting it to make a submission in support of its application, also addressing the paragraph 5 criteria. The Commission published a notice on 5 February 2005 inviting submissions from interested parties about the applications. No submissions were received.

1.5 On 23 February 2005 Qantas applied for the two all-cargo weekly frequencies available on the Netherlands route, addressing the paragraph 5 criteria in doing so. Qantas plans to operate on a routing of Sydney – Shanghai – Amsterdam – Mumbai – Singapore –

Sydney. The airline intends to introduce services with a single weekly frequency from June 2005, adding a second weekly service from the start of the Northern Winter 2005 season (November 2005).

1.6 Qantas proposes to operate B747-400 freighter aircraft wet-leased from Atlas Air, from which it already wet-leases three aircraft. Atlas Air is a United States-based company providing a range of freight services world-wide, including ACMI leasing (aircraft, crew, maintenance and insurance) which is the arrangement with Qantas.

1.7 Also on 23 February 2005, HeavyLift made a submission in support of its application. This addressed the paragraph 5 criteria, in response to the Commission's invitation to do so. On 4 March 2005, HeavyLift made a further submission, responding to aspects of Qantas' application for capacity. Qantas in turn responded on 21 March 2005 to HeavyLift's 4 March submission.

1.8 All public material supplied by the applicants is filed on the Commission's Register of Public Documents. Commercial-in-confidence material provided by both of the applicants is filed on the Commission's Confidential Register.

2 Current services

2.1 The Netherlands route is served by all-cargo flights by Martinair Holland, which operates twice-weekly B747-200 services on a routing Amsterdam-Sharjah-Singapore-Sydney-Hong Kong-Bangkok-Sharjah-Amsterdam.

2.2 Looking at the UK/Europe markets more generally, Qantas operates twice-weekly B747-400 all-cargo services to Frankfurt via Shanghai, with freight distributed from Frankfurt to other points in Europe. The twice-weekly services return from Frankfurt via Mumbai and Singapore to Sydney.

2.3 A substantial number of alternate all-cargo services to and from points in the UK/Europe, including Amsterdam and Frankfurt, are provided by third-country carriers, particularly over Asian points. Korean Air, Singapore Airlines and Cathay Pacific are the main carriers.

2.4 Further competition in UK/Europe freight markets is provided from many passenger carriers selling belly-hold capacity, including Qantas to points in the UK/Europe but not the Netherlands directly. KLM, the Netherlands passenger carrier, does not operate services in its own right from the Netherlands, but code shares on services operated by Malaysia Airlines between Kuala Lumpur and Australia.

3 Provisions of relevant air services arrangements

3.1 There are two all-cargo services per week of capacity remaining available for allocation to Australian designated airlines on the Netherlands route. The air services arrangements between Australia and the Netherlands permit multiple airline designation. Understandings between the Australian and Dutch aeronautical authorities indicate that services may be operated via Shanghai with the exercise of traffic rights, as proposed by

Qantas and HeavyLift. The air services arrangements between Australia and China grant Australian carriers traffic rights consistent with the services proposed by HeavyLift and Qantas. The air services arrangements between Australia and India and between Australia and Singapore are consistent with Qantas' plans.

4 Summary of applicants claims, including against the paragraph 5 criteria

4.1 A summary of the applicants claims, including against the paragraph 5 criteria in the Minister's policy statement, are summarised below.

Background information

4.2 Qantas provided background information as the lead in to addressing the paragraph 5 criteria. HeavyLift responded to aspects of the Qantas application. Qantas in turn commented on aspects of HeavyLift's response.

Qantas background information

4.3 In its covering letter, Qantas outlined the history of its plans to operate freighter services between Sydney and Amsterdam via Shanghai. Qantas had previously been allocated capacity by the Commission on the Netherlands route, but had handed this back following concerns about whether fifth freedom rights were available between Shanghai and Amsterdam. Although this issue had been satisfactorily resolved before Qantas was required to start services, by that stage the airline had committed its aircraft to serving Frankfurt instead of Amsterdam. These new services commenced in November 2004. Qantas has recently arranged for the wet-lease of a fourth Atlas Air B747 freighter from June 2005, which will provide the airline with equipment to serve the Amsterdam market as originally planned.

4.4 Qantas commented on HeavyLift's application, expressing surprise that HeavyLift claimed the capability to commence long haul international services. Qantas also argued that HeavyLift's services may not be sustainable in the long term. Qantas also expressed doubts about Kalitta Air's likely long term commitment to any venture performing below expectations.

4.5 Qantas provided background information specific to addressing the paragraph 5 criteria. Qantas explained its arrangements with Atlas Air for the wet-lease of aircraft (currently three) to operate dedicated freighter services, which involved a consolidation of previous wet leasing arrangements with other companies. Qantas stated that the comparatively liberal bilateral rights available for the operation of freight services under various air services arrangements, compared with passenger services, together with a strong growth outlook for air freight traffic, provide the basis for the growth of its dedicated freighter services. Recent liberalisation of the Australia-China and Australia-India air services arrangements, in particular, have provided important new opportunities.

4.6 Qantas set out the network of services it currently operates and its plan for the use of the fourth Atlas Air aircraft. This involves intended services from Australia to Shanghai-

Frankfurt-Chicago-Los Angeles and back to Sydney, as well as the planned Sydney-Shanghai-Amsterdam services associated with this current application for capacity on the Netherlands route.

4.7 Qantas said that operations to both Frankfurt and Amsterdam would provide freight forwarders, exporters and importers with greater choice in destinations, product, and dates and times of travel. Qantas stated that it has suitable sales infrastructure and necessary regulatory approvals mostly arranged. Qantas has engaged Menzies World Cargo to carry out its ramp, cargo warehousing and ground handling services.

HeavyLift response of 4 March 2005 to Qantas

4.8 HeavyLift took issue with Qantas' views about the commitment of Kalitta Air to the arrangements with HeavyLift. HeavyLift said that Atlas Air had been in Chapter 11 bankruptcy proceedings in 2004. HeavyLift contended that there was more likelihood of Atlas Air failing and leaving Qantas without aircraft, than the same occurring in relation to Kalitta Air and HeavyLift.

4.9 HeavyLift stated that Qantas, like HeavyLift, was able to use an extensive trucking network in Europe for the distribution of freight. For this reason, Qantas could fly to Luxembourg or Germany just as easily as the Netherlands. On the other hand, HeavyLift must fly to Amsterdam, Kalitta Air's hub where it needed to hand the aircraft back to Kalitta Air under their commercial arrangements, and distribute freight by truck from there.

4.10 Qantas' claims about the relative reliability and costs of operating the B747-400 relative to the B747-200 were disputed by HeavyLift. HeavyLift stated that Kalitta Air's dispatch reliability from Amsterdam is 98.6%. HeavyLift also argued that the weight carrying capacities of the two aircraft types were the same for all practical purposes. HeavyLift said that the B747-400 was likely to "bulk out" (that is, the volume of the aircraft would be fully occupied) before weight limits were reached.

4.11 HeavyLift also took issue with what it saw as Qantas' negative assertions about HeavyLift, stating that the two airlines have a commercial relationship, with HeavyLift interlining 80,000 kilograms per week of tuna from south-west Pacific points to Qantas services from Australia to Japan.

4.12 HeavyLift claimed that it would have in excess of a 40% operating cost advantage to Europe via China and from the United States to Australia and looked forward to demonstrating this to the market. HeavyLift reiterated the point made in its application that its base loads were underwritten by two major cargo companies.

Qantas letter of 21 March, responding to HeavyLift's 4 March letter

4.13 Qantas argued that HeavyLift's letter cast further doubt on whether HeavyLift's operation using Kalitta Air aircraft constituted a genuine wet-lease arrangement. Qantas suggested that the arrangement may involve a foreign carrier taking advantage of Australian traffic rights through commercial arrangements with an Australian carrier. Qantas argued that if the wet-leasing arrangements were genuine, then HeavyLift being unsuccessful in securing the Netherlands capacity should not preclude it from operating the other routes proposed, as HeavyLift claimed would be the case.

4.14 Qantas repeated the statements in its original application that it would have been operating to Amsterdam for some time, had uncertainty not been created by the Netherlands authorities questioning the entitlement of Australian carriers to exercise full traffic rights between Shanghai and Amsterdam. That matter was unable to be resolved before Qantas was obliged for operational and regulatory reasons to select an alternative European point. This led to Qantas handing back the capacity on the Netherlands route that had been allocated to it by the Commission.

4.15 Qantas maintained its view that the payload capability of its B747-400 aircraft exceeded that of HeavyLift's B747-200 aircraft, and that its current services from Shanghai often reach maximum gross payload.

4.16 Qantas said that Atlas Air was a separate company from Polar Air and that Qantas has no leasing arrangement with Polar Air. Qantas expressed confidence in the financial circumstances of Atlas Air.

4.17 Finally, Qantas noted that there are other carriers operating cargo services on the US route, which provide competition for Qantas.

Summary of claims against the paragraph 5 criteria

4.18 Not all of the criteria in the Minister's policy statement are relevant to this case, as there is no carriage of passengers involved. The principal relevant criteria are those relating to competition benefits, and the "other benefits" criteria of trade benefits and industry structure. Both carriers addressed these three criteria. HeavyLift also addressed the consumer benefits criterion, but the Commission considers that the benefits claimed by HeavyLift appropriately relate to the trade criterion. The Commission has assessed HeavyLift's claims on that basis. In addition, HeavyLift addressed the "other criteria" of the policy statement.

Competition benefits

HeavyLift

4.19 HeavyLift submitted that an allocation of capacity to it would enhance competition in the air freight market between Australia and the Netherlands as well as between Australia and Europe more generally. HeavyLift recorded that it had established a presence on the south-west Pacific and had operated long haul charter cargo flights to Kuwait and Spain. HeavyLift considered that the expansion of its operations would improve its ability to compete more generally with foreign carriers in the south-west Pacific and improve its profitability.

4.20 HeavyLift noted that the Netherlands route is served directly only by Martinair, and observed that Qantas had previously held capacity allocations but relinquished these. HeavyLift noted that Qantas and Martinair codeshare on the route and that this provides little incentive for competition between them. HeavyLift considered that it should be given the opportunity to prove a long term commitment to the route.

4.21 HeavyLift stated that its operating costs were below those of its competitors in other markets and considered that this would be the case on the Netherlands route also,

translating into lower tariffs. HeavyLift's introduction of two services per week would benefit air freight shippers to the region and provide a choice of carriers.

4.22 HeavyLift noted that Amsterdam is a hub for intra-European freight services and thus the services provided an alternative means for shipping of freight throughout Europe, aside from through Qantas' hub at Frankfurt. Further, the arrangement between HeavyLift and Kalitta Air would allow the two to provide global connections. The ability of HeavyLift to use Kalitta Air's range of support services would assist HeavyLift's expansion.

Qantas

4.23 Qantas stated that it would face direct competition from Martinair Holland. Qantas plans to compete with Martinair's weekend services, as well as offering a mid-week service to provide increased choice.

4.24 Qantas said that it would also face substantial competition from indirect all-cargo operators, mainly those based in Asian hubs including Korean Air, Singapore Airlines and Cathay Pacific. Further competition is provided through passenger services with belly-hold freight capacity operating between Australia and points in UK/Europe.

4.25 Qantas argued that it would only be able to compete effectively in global markets if it has sufficient scale, breadth of network and marketing presence. To achieve this, Qantas needs to be able to implement its growth plans.

4.26 Qantas claimed that in such a competitive market the outlook for a prospective new operator such as HeavyLift is questionable, with its lack of a broader network and small scale. Qantas argued that Australia may achieve a lower market share if HeavyLift was to operate twice-weekly services, compared with that which would be achieved should Qantas operate the services.

4.27 Qantas stated that there is fierce price competition in Australia – UK/Europe freight markets. Qantas said that its initial strategy would be to focus on building market share, but with a longer term aim of balancing acceptable loads with reasonable rates. Qantas provided confidential information about its market pricing to the Commission. Qantas said that it was able to common-rate freight rates from its larger Australian ports with Sydney, as well as points within Europe. This could not be achieved without Qantas' extensive network of services.

4.28 Qantas said that it would offer superior product features and services. Qantas outlined the facilities available for freight, including for specialised commodities. Qantas described the e-business facilities and other services available to its customers.

4.29 Qantas pointed out that it would carry the full cost of its exposure under the wet-lease arrangements with Atlas Air and that this would create an incentive to ensure its services are commercially sustainable.

Other benefits - Trade benefits

HeavyLift

4.30 HeavyLift submitted that its services would provide significant benefits to Australian exporters, giving them additional choice of carrier and departure times, both for services to the Netherlands and to China. The additional option available to exporters and others using the services would potentially stimulate an improvement in the product offered. HeavyLift also considered that it was in a position to offer lower tariffs on the route than Qantas.

4.31 HeavyLift stated that its wet-lease arrangement with Kalitta Air would complement Kalitta Air's existing services from Amsterdam to New York and on to Los Angeles. These services would connect with the HeavyLift services between Los Angeles and Sydney, making a round the world operation. Benefits would be derived for users of the United States – Australia services also.

4.32 HeavyLift stated that the Kalitta Air aircraft had a good level of reliability. This, together with the doubling of frequencies on the Netherlands route would be of significant benefit to Australian exporters and importers and generally to the Australian economy.

Qantas

4.33 Qantas stated that there was low demand for freight space in the Australia – Amsterdam market, particularly ex-Australia, but nevertheless planned to set aside 20% of its capacity on the aircraft for operations on this sector. However, the services as a whole would be largely supported by demand in the China – Netherlands market.

4.34 Qantas said that Amsterdam is a key European freight centre with cheaper handling than many other European cities. It has good inter-modal transfer arrangements, allowing trans-shipment to and from many destinations in the UK and Europe. Qantas' services to Amsterdam would operate at different times from those it operates to Frankfurt, providing choice of destinations and cut-off times for cargo delivery.

4.35 Qantas stated that the B747-400 aircraft leased from Atlas Air had greater capacity than those to be operated by HeavyLift. The aircraft were also more reliable than the older B747-200s used by HeavyLift.

4.36 Qantas highlighted its network arrangements which provide extensive access to freight customers world-wide and domestically. Qantas also described its freight distribution network including call centres and other sales distribution arrangements.

4.37 Qantas contended that its B747-400 aircraft offered cost advantages with their longer range mitigating the need for some refuelling stops, although much cost advantage derived from network and scale considerations. Those economies of scale enable reduced unit costs. The ability to operate the impending fourth B747-400 aircraft to Amsterdam as well as Frankfurt and elsewhere would allow for more effective aircraft utilisation and spread fixed costs over an extra service.

4.38 Qantas considered that the branding of its aircraft in Qantas livery would assist in promoting Australia's trade interests overseas.

Other benefits - Industry structure

HeavyLift

4.39 HeavyLift observed that it was a relatively new Australian airline, and one of the few providing dedicated international cargo services, with markets dominated by foreign airlines. HeavyLift stated that its scheduled and charter operations thus far had been successful. Entry to the Netherlands route is regarded as the first step of an expansion into becoming a major cargo carrier. HeavyLift argued that a strong cargo carrier would be of benefit to the Australian aviation industry and the Australian economy.

Qantas

4.40 Qantas stated that its recent expansion into dedicated freight services represented a step forward in the development of a competitive Australian air freight industry. Qantas argued that it needed to build a critical mass of services as quickly as possible in order to be successful. The Netherlands services were an important part of the proposed utilisation of the fourth B747 freighter. Qantas provided commercial in confidence information to show the business case for the proposed services.

4.41 The extra services would strengthen Australia's aviation industry and ancillary businesses, as well as being important for future investment, employment and skills development.

Other criteria

HeavyLift

4.42 HeavyLift argued that its operations would improve competition on the United States and China routes, as well as on the Netherlands route. However, without the capacity to the Netherlands, the other routes would not be viable in their own right. HeavyLift also restated a number of points made earlier in its submission.

5 The draft determination

5.1 On 1 April 2005 the Commission issued a draft determination proposing to allocate two all-cargo services per week to HeavyLift. The Commission proposed that the determination would be for a period of three years and that HeavyLift would have until 1 November 2005 to fully utilise the capacity. Interested parties were invited to comment on the draft determination. Qantas did so in a letter of 14 April 2005. In its letter of 20 April 2005 HeavyLift responded to aspects of Qantas' comments concerning utilisation of capacity by HeavyLift.

5.2 Qantas advised that the code share arrangement with Martinair Holland referred to in the draft determination had been terminated some time ago. Qantas considered that this altered the premise about the level of competition on the Netherlands route and the Commission might therefore reconsider its decision in the light of this. Qantas also advised that, although it did have a commercial relationship with HeavyLift, this had been terminated.

5.3 Qantas contrasted its approach to the use it or lose it principle with that of HeavyLift. Qantas restated references in its original application to its handing back of unused Netherlands cargo capacity. It argued that HeavyLift had not adopted the same

approach and had held capacity unused on several south-west Pacific routes. Qantas considered that HeavyLift's track record of the under-utilisation of capacity cast doubt on its ability to satisfy the requirements of paragraph 4 of the Minister's policy statement.

5.4 Qantas considered that the draft determination allowed HeavyLift too much time in which to fully utilise the capacity, particularly given that the case is a contested one. Qantas suggested that the end of July 2005 would be a more appropriate deadline, given that HeavyLift had indicated an intention to start services by that time. If HeavyLift was unable to start services by end-July, Qantas would have the opportunity to seek the capacity, minimising the potential loss of public benefit.

5.5 Finally, Qantas suggested that an alternative open to the Commission is to split the capacity between Qantas and HeavyLift, although Qantas maintained that the public benefit would be maximised by allocating both weekly frequencies to Qantas. Qantas indicated that a once-weekly frequency would represent a workable starting point for it to service the Netherlands market. Should HeavyLift fail to implement a once-weekly service of its own, Qantas would be in a position to start a second service by November 2005 as originally proposed.

5.6 Martinair also made a submission in response to the draft determination to advise that there was no code share arrangement between it and Qantas. Martinair also advised that it was not a member of a conglomerate with Air France and KLM, contrary to the statement to this effect made by Qantas in its submission.

5.7 The Commission has addressed in its assessment below the additional comments provided by Qantas and HeavyLift in their respective letters. As noted, Qantas and Martinair identified incorrect references in the draft determination to a code share arrangement between Qantas and Martinair. These references have been removed in this final determination. The Commission had relied on the latest approved international timetables published by the Department of Transport and Regional Services in making the reference. The Commission notes that little weight was given to the code share issue in the comparative benefits assessment in the draft determination.

6 Commission's assessment

Introduction

6.1 There are no Australian carriers operating on the Netherlands route, so the start up provisions of the Minister's policy statement are not applicable in this case. Under paragraph 6.2 of the Minister's policy statement, where there are other applications or submissions received about or opposing a proposal, the Commission may apply the additional criteria in paragraph 5 of the policy statement, as well as the paragraph 4 criteria. The Commission will apply both the paragraph 4 and 5 criteria in this case.

Paragraph 4 assessment

6.2 Under paragraph 4, the use of Australian entitlements by a carrier that is reasonably capable of obtaining the necessary approvals (4(b)(i)) and of implementing its proposals

(4(b)(ii)) is of benefit to the public. In relation to obtaining the necessary approvals, airlines must be designated and obtain timetable approval from the Department of Transport and Regional Services (the Department) and safety approvals from the Civil Aviation Safety Authority (CASA) before services on a new route can be commenced. The Commission makes its own assessment of whether applicants are reasonably capable of implementing their proposals, taking account as appropriate of factors such as the experience of the applicants, their specific plans for the route, and other information the Commission considers relevant in the circumstances of the particular case.

6.3 The Commission considers that Qantas, as an established airline, is reasonably capable of obtaining the necessary approvals and of implementing its proposals.

6.4 When HeavyLift was seeking to establish itself as an international operator in mid-2003, the Commission conducted a detailed assessment of its business plan and finances. The Commission found at that time that HeavyLift was reasonably capable of obtaining the necessary approvals of implementing its proposals. In the event, HeavyLift did prove itself capable, and has operated successfully for some time both scheduled and charter services on a range of routes. These have included long haul charter services.

6.5 In its original application, submissions and response to the draft determination, Qantas has questioned HeavyLift's ability to implement its proposals, citing under-utilisation of capacity by HeavyLift on several routes. The Commission recognises that HeavyLift has taken longer than planned to fully implement services on some routes in the south-west Pacific. However, in large part this has been for reasons outside HeavyLift's control and the airline has kept the Commission and the Department of Transport and Regional Services advised on these matters. The airline is nevertheless well established on some routes. Further, HeavyLift's letter of 20 April 2005 states that it is now fully using its Papua New Guinea capacity, and approvals have been obtained from the Vanuatu aeronautical authorities and services on this route will commence in May 2005.

6.6 Although HeavyLift is a relatively well-established carrier, because it is planning to operate long haul routes on a scheduled basis for the first time, the Commission has assessed the publicly provided and commercial-in-confidence material supplied by HeavyLift in support of its application. HeavyLift has provided evidence of contractual arrangements which would underpin the commercial viability of its services. It has also entered into arrangements with an established international cargo operator, Kalitta Air, which should ensure reliable operations, a high level of support services and local knowledge. The Commission is satisfied that HeavyLift's plans are sound and that it is reasonably capable of implementing its proposals.

6.7 In summary, the Commission considers that both Qantas and HeavyLift are reasonably capable of obtaining the necessary approvals and of implementing their proposals.

Paragraph 5 assessment

Overview of markets

6.8 As background to the Commission's consideration, the following overview of freight carriage in the markets along the route out of Australia illustrates the opportunities available for Australian carriers to which both HeavyLift and Qantas are seeking to gain access.

6.9 The value and volume of freight exported by air from Australia to the Netherlands and Australia to China is not large, as the following two tables illustrate. The tables show the top five commodity groups ranked by value for each of the markets.

AUSTRALIAN AIR FREIGHT EXPORTS TO THE NETHERLANDS (Y/E SEPTEMBER 2004)

PRODUCT	VALUE (\$M)	WEIGHT (tonnes)
Medicinal & pharmaceutical	164	257
Other commodities	119	119
Professional & scientific apparatus	19	69
Miscellaneous manufactured articles	15	114
Electrical machinery	10	60

6.10 The total value of exports by air to the Netherlands for the year was \$369 million. The total weight carried was 1,738 tonnes, or an average of 33 tonnes per week.

AIR FREIGHT EXPORTS TO CHINA (Y/E SEPTEMBER 2004)

PRODUCT	VALUE (\$M)	WEIGHT (tonnes)
Other commodities	48	279
Medicinal & pharmaceutical	37	177
Electrical machinery	25	170
Professional & scientific apparatus	24	126
Office machines & equipment	17	54

6.11 The Australia – China market is less by value than the Australia - Netherlands market, with a total of \$249 million of freight being exported by air to China for the year. However, the weight of freight carried by air to China totalled 3,719 tonnes, an average of about 71 tonnes per week, or over double that on the Australia - Netherlands segment.

The China – Netherlands/other Europe markets

6.12 However, in addition to these sectors, both carriers would have access to trade moving between China and the Netherlands, and also to freight destined for points beyond the Netherlands in Europe. Qantas indicated that up to 80% of its capacity would be dedicated to carriage of traffic other than Australia – Netherlands trade. HeavyLift could also be expected to focus on the wider markets available in operating on the Netherlands route.

6.13 The China – Netherlands market in particular, represents a major market opportunity for Australian carriers operating on the Netherlands route. Information

published by the International Air Transport Association (*Passenger and Cargo Forecasts 2004 – 2008*) identify the China – Netherlands market as likely to be the fastest growing international freight market over the next five years. The anticipated growth rate is 23%. The market is already much larger than Australia – China and Australia – Netherlands, with about 37,000 tonnes of freight carried on the route in 2003.

Assessment against the paragraph 5 criteria

6.14 The Commission’s comparative assessment of the respective proposals against the paragraph 5 criteria in the Minister’s policy statement of 19 May 2004 is set out below. As noted earlier, the Commission has excluded from its assessment the “other” criteria of tourism and consumer benefits, as these have little or no relevance to a consideration of public benefits associated with cargo-only operations.

6.15 The Commission notes the primacy given to the competition criterion by virtue of paragraph 5.2 of the Minister’s policy statement, which says that “In applying all criteria, the Commission should take as the pre-eminent consideration, the competition benefits of each application”. The policy statement guides the Commission as to the matters it should have regard to when assessing the applications for their comparative competition benefits, and these are set out as follows:

Competition Benefits

In assessing 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 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 agreement 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 on 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.*

6.16 Both applicants have discussed the benefits that they expect to arise through competing against foreign carriers in multiple markets from operations on the Australia –

Netherlands route. Both would be competitors in the Australia – Netherlands market, but competition would also arise in the Australia – China, Australia – other-Europe and China – Netherlands/other-Europe markets. It is the rapidly growing freight markets between China and the Netherlands and other European points which provide a major opportunity for the two airlines. Accordingly, both Qantas and HeavyLift will intend to distribute freight beyond the Netherlands to other points in Europe. The Netherlands is an important European freight hub and both carriers would be able to take advantage of excellent trucking facilities to achieve distribution.

6.17 Qantas would offer significant competition for foreign carriers in all market segments along the route. Qantas already operates to China and beyond to Frankfurt. The extra services to China would bolster Qantas' ability to compete with foreign carriers in this market. The services beyond China enable it to compete with those carriers in markets to Netherlands and other points in Europe, complementing its existing China – Frankfurt services.

6.18 The introduction of HeavyLift services to China and beyond to the Netherlands involves different impacts than would new Qantas services. HeavyLift would introduce competition for existing Qantas services on the China route. In addition, HeavyLift would be in a position to compete with Qantas for traffic it carries to points in Europe (over Frankfurt). HeavyLift would compete with the same international carriers as would Qantas. HeavyLift would increase choice of carriers on the route, and provide scope for increased innovation and service options. Overall, the entry of HeavyLift to the Netherlands route would have a substantial competitive impact, as it is effectively providing competition in multiple markets for both Qantas and foreign carriers.

6.19 A spin-off of HeavyLift's entry to the Netherlands route is that it would facilitate the introduction of capacity into the United States route, and this would provide new competition for Qantas as well as foreign carriers on the route. Without the allocation on the Netherlands route, HeavyLift's plans for the US route are unlikely to be implemented for commercial reasons.

6.20 For its part, Qantas' services would return to Australia via Mumbai and Singapore, providing important opportunities for importers of freight from the Netherlands, India and Singapore. Qantas' existing services from Frankfurt return to Australia via Mumbai and Singapore, so the new services provide added choice of date of shipment for importers from those points. The services would provide competition with existing international carriers, although not with any other Australian operator.

6.21 In terms of logistical arrangements, Qantas has established facilities and systems which can be adapted readily to support operations to Amsterdam. HeavyLift will take advantage of the established facilities of Kalitta Air. Both carriers have access to distribution arrangements at Amsterdam which will allow them to efficiently forward freight to other countries in Europe.

6.22 Both carriers propose to provide capacity on wet-leased aircraft under ACMI (aircraft, crew, maintenance and insurance) arrangements. The applicants have presented arguments about the relative merits of the different B747-series aircraft they propose to operate. Qantas has argued that the larger carrying capacity and operating efficiency of the 400-series aircraft provide it with an advantage. HeavyLift has disputed this, arguing that its

costs will be lower than those incurred by Qantas, providing HeavyLift with greater scope to discount freight rates. Qantas and HeavyLift provided both public and commercial-in-confidence information about operating costs and possible freight rates. HeavyLift's aircraft are an older model than those to be used by Qantas with significantly lower leasing costs but somewhat higher fuel costs. Overall, the Commission considers that HeavyLift has a meaningful cost advantage over Qantas, although not in the order of the 40% claimed by HeavyLift. This means that HeavyLift is well placed to offer competitive rates in the market.

6.23 Qantas has argued that denying it the Netherlands capacity would adversely affect its scale and breadth of network. The Commission acknowledges that the Netherlands provides an important commercial opportunity for dedicated freight operators. However, it is not convinced that not receiving the Netherlands capacity would have a major affect on Qantas' overall scale and breadth of network. The Commission considers that Qantas would have other options should it not be allocated the Netherlands capacity. Qantas already has plans to expand its existing operations to Frankfurt and should be able to exploit this and other bilateral opportunities to achieve similar scale advantages to those which it claims would be derived from the Netherlands services.

6.24 Denying the capacity to HeavyLift is likely to have a more severe impact on its ability to develop scale and network breadth compared with Qantas. HeavyLift has argued that the structure of its arrangements with Kalitta Air mean that HeavyLift is unlikely to be able to make alternative operational plans. The airline has stated that it is likely to abandon its long-haul plans if it is not successful in this case. Qantas has argued that HeavyLift's wet-leasing arrangements do not provide a sound basis to argue that alternative plans could not be implemented when other bilateral opportunities are available.

6.25 The Commission considers that while HeavyLift's commercial arrangements do appear to be somewhat inflexible, the fact remains that HeavyLift is unlikely to pursue alternative arrangements if it is unable to secure the Netherlands entitlements, as the proposed services to Amsterdam form part of an integrated operation. This would mean that there would be no Australian competitor for Qantas in the China and European export markets, nor for the inbound market from the United States.

6.26 In summary, the Commission concludes that competition benefits will be maximised through the operation of the capacity by HeavyLift. The HeavyLift proposal would introduce competition for Qantas as well as foreign carriers in multiple markets. HeavyLift's cost structure should enable it to offer very competitive freight rates. It offers exporters and importers an additional choice of Australian carrier, with the likely benefits in choice of departure times and innovations that should bring.

Other criteria

6.27 The other relevant criteria for the Commission to consider are trade benefits and industry structure implications. The Commission's assessment against each of these criteria is as follows:

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.*

6.28 Both carriers propose to operate the same frequency of service, namely two services per week, the maximum available under the bilateral arrangements between Australia and the Netherlands. Australian exporters will benefit substantially from the availability of the additional space to China, the Netherlands and other points in Europe.

6.29 Although Australian exporters gain no direct benefit from Australian carrier participation in markets between third countries, they do benefit from the fact that services on the Australia – China – Netherlands route would probably not be operated at all without the carriers having access to that third-country traffic. Thus, both carriers' proposals offer substantial benefits to Australian exporters through providing space for them to gain better access to the China, Netherlands and other European markets.

6.30 As noted above, both applicants have mounted arguments about the carrying capacity of their respective aircraft. Although the Qantas aircraft has a higher weight capability, HeavyLift argues that, in most cases, this would have no practical effect, with freight volumes on both aircraft generally being fully utilised before weight limits were reached. Qantas has disputed this, stating that current services out of China frequently reach weight limits before volumes are fully used. The Commission considers that there is a modest advantage for Qantas in its ability to achieve higher weight limits and therefore a greater amount of freight from time to time. However, this is unlikely to occur on all flights and not on all sectors.

6.31 Qantas has also argued that the reliability of its aircraft is superior to that of HeavyLift. HeavyLift has disputed this. The Commission finds that both carriers are leasing aircraft from large, reputable and well-established aircraft leasing companies. This is likely to mean high reliability levels for both airlines. There is no convincing evidence that Qantas would have any significant reliability advantage over HeavyLift.

6.32 As noted above, HeavyLift appears to have cost advantages over Qantas, meaning that exporters and importers stand to benefit from the competitive rates that HeavyLift should be able to offer.

6.33 Both carriers are able to access extensive freight distribution networks in Amsterdam for the shipment of freight to other points in the UK/Europe. At the Australian end of the route, Qantas can claim a superior network of services within Australia behind Sydney, which enable it to draw in freight for export from other Australian cities and for distribution of imported freight. HeavyLift's ability to access freight from other cities is more limited, although its arrangements with DHL should assist to some extent.

6.34 The Commission concludes that each carrier has some advantages over the other against this criteria. Overall, the Commission considers that HeavyLift's scope to offer lower rates, as well as a differentiated service to exporters, tilts the balance of benefits against this criteria in its favour.

Industry Structure

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

6.35 The Commission considers that the entry of either carrier would have a positive impact on the Australian aviation industry. The successful participation in the route, including the large third-country markets, will contribute to increased employment and other benefits to the Australian aviation industry. Over the longer term, the establishment of a long-haul operating capability by HeavyLift is likely to have the greater impact on the Australian aviation industry, as it will provide the basis for it to join Qantas in competing more broadly with international carriers.

Conclusion

6.36 The Commission considers that both HeavyLift and Qantas are reasonably capable of obtaining the necessary approvals and of implementing their proposals. The Commission finds that public benefit is likely to be maximised by the introduction of services by HeavyLift on to the Netherlands route. HeavyLift would provide competition to Qantas and foreign carriers in the markets between Australia and China, the Netherlands and other European markets, as well as providing the basis for competition on flights inbound from the United States. It is likely that, should this capacity be allocated to Qantas, HeavyLift would not proceed with its plans and the public benefits associated with HeavyLift's entry to these multiple markets would be lost.

6.37 The Commission has considered the possibility of splitting the capacity between the two carriers, as suggested by Qantas in its response to the draft determination. This is an option that the Commission has taken up in the past (for example, in splitting capacity between HeavyLift and Pacific Air Express on the Papua New Guinea route - Determination [2003] IASC 123 refers).

6.38 The Commission would split the capacity if the benefits of doing so were likely to be greater than the benefits of allocating both units of capacity to HeavyLift as proposed in the draft determination. Qantas has offered little additional evidence to suggest that this would be the case. Qantas has suggested that a strong established competitor such as itself is required to challenge the position of Martinair. The Qantas proposition also offers a fall-back position in the event that HeavyLift was unable to successfully operate a single weekly service, in that Qantas would then be in a position to seek allocation of the second weekly service.

6.39 The Commission considers it likely that HeavyLift would have difficulty sustaining a once per week operation on the Netherlands route, in part because it would almost certainly make it impractical for HeavyLift to implement its inter-related proposals of a twice weekly service to China and twice-weekly services from the United States to Australia. HeavyLift, initiating long haul services, is in a different position to Qantas, for which a single weekly service to the Netherlands represents an increment to established long-haul cargo operations. The difficulties in competing effectively on long haul routes because of lack of scale, which Qantas itself has identified, would be exacerbated for HeavyLift if it was to be able to offer only one service per week. If the services were terminated quickly, this would probably result in Qantas ending up with both services, as it suggests itself would be the probable outcome. While this would still represent a public benefit, in the Commission's view the benefits would be less than if a second Australian carrier, namely HeavyLift in this case, were to exercise all of the capacity.

6.40 The Commission will issue a determination allocating two all-cargo services per week on the Netherlands route to HeavyLift. As the case has been contested and both carriers are found to be reasonably capable of implementing their proposals, the Commission will issue an interim (three year) determination, consistent with its approach in a number of previous cases. Under the Minister's policy statement, an interim determination provides other carriers with stronger criteria against which to seek to have the capacity allocated to them at the renewal stage, compared with a full five year determination which carries a rebuttal presumption in favour of the incumbent.

6.41 The Minister's policy statement gives the Commission discretion in specifying a period within which a carrier must fully utilise allocated capacity. The Commission has generally provided flexibility for carriers in fully utilising allocated capacity, particularly on new routes. In its draft determination, the Commission proposed to require HeavyLift to fully utilise its allocated capacity by 1 November 2005.

6.42 Qantas has argued that HeavyLift should have a shorter time within which to fully use the capacity because the case is a contested one and Qantas stands ready to use the capacity if HeavyLift is unable to do so. The Commission is conscious of the desirability of seeing the capacity used as quickly as possible. However, the Commission remains of the view that HeavyLift should be granted an adequate period within which to utilise the capacity because it is seeking to establish long haul scheduled services for the first time and because of the public benefits that should arise over time. This period should include a reasonable allowance for the resolution of unforeseen difficulties that may arise in the establishment process. The Commission would have provided the same flexibility to Qantas, had that carrier been allocated the capacity, noting that Qantas had not proposed to fully utilise the capacity until November 2005 in any case. The Commission will therefore require the capacity to be fully utilised by 1 November 2005

6.43 However, the Commission would not want a situation to develop whereby HeavyLift held the capacity unused beyond 1 November. The Commission will therefore monitor closely HeavyLift's preparations towards the utilisation of this capacity. Should it become apparent that HeavyLift is unlikely to fully use the capacity by the required date, the Commission would promptly initiate a formal review process to ensure that the capacity did not remain idle.

7 Determination allocating capacity on the Netherlands route to HeavyLift (Australia) Pty Ltd [2005] IASC 103

7.1 The Commission makes a determination in favour of HeavyLift, allocating two all-cargo services per week on the Australia – Netherlands route, in accordance with the Australia – Netherlands air services arrangements.

7.2 The determination is for three years from the date of the determination.

7.3 The determination is subject to the following conditions:

- HeavyLift is required to utilise the capacity from no later than 1 November 2005 or from such other date approved by the Commission;

- only HeavyLift is permitted to utilise the capacity;
- HeavyLift is not permitted to utilise the capacity to provide services jointly with another Australian carrier or any other person without the approval of the Commission;
- changes in relation to the ownership and control of HeavyLift are permitted except to the extent that any change:
 - results in the designation of the airline as an Australian carrier under the Australia – Netherlands air services 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 HeavyLift or be in a position to exercise effective control of HeavyLift, without the prior consent of the Commission; and
- changes in relation to the management, status or location of operations and head office of HeavyLift 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 – Netherlands air services arrangements.

Dated 16 May 2005

John Martin
Chairman

Vanessa Fanning
Member

Michael Lawriwsky
Member