Australian Government

International Air Services Commission

DECISION

Decision:	**[2006] IASC 225**
Variation of:	**[2003] IASC 108, [2004] IASC 119 and [2005] IASC 125**
The route:	**South Africa**
The applicant:	**Qantas Airways Limited (ACN 009 661 901) (Qantas)**
Public Register File:	**IASC/APP/200619**

1 The application

1.1 Qantas applied to the Commission on 25 October 2006 to vary Determinations [2002] IASC 117 (or as renewed), [2003] IASC 108, [2004] IASC 119 and [2005] IASC 125 to permit South African Airways (SAA) to continue code sharing on Qantas services between Australia and South Africa until 31 December 2008. The Commission first authorised code sharing between Qantas and SAA in Decision [2000] IASC 217 of 11 December 2000 and has granted successive authorisations since, most recently in Decision [2005] IASC 204 of 30 June 2005. The current period of approval ends on 18 December 2006.

1.2 A detailed confidential submission was received from Qantas in a letter dated 17 November 2006. This was provided in response to a request by the Commission for additional information relating to Qantas' operations on the South Africa route.

1.3 On 1 November 2006, the Commission published a notice inviting submissions from interested parties about the application. A submission was received from the West Australian Government on 15 November 2006. The Commission also wrote on 31 October 2006 to the Australian Competition and Consumer Commission (ACCC) inviting its views on the Qantas proposal. The Commission is required by the Minister's policy statement to consult with the ACCC when the IASC has concerns about the competition effects of a particular code share proposal. The ACCC provided a submission on 20 November 2006. Qantas responded to the ACCC's submission by letter on 24 November 2006.

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

2 Current services

2.1 Qantas currently operates five B747-400 three-class return services per week between Sydney and Johannesburg. A fifth weekly service was added in early December 2005, meeting a condition of the Commission's continued approval of the code share arrangements. SAA operates five A340-200 two-class return services per week between Johannesburg and Perth. Under the code share agreement between the two carriers, Qantas purchases blocks of 10 business class and 90 economy class seats on each SAA service. SAA buys average blocks of two first class, 24 business class and 124 economy class seats on each Qantas service.

2.2 Qantas advised in its application that SAA plans to introduce A340-300 aircraft to the Perth sector, which would provide additional capacity compared with the current 200-series aircraft.

2.3 A number of services via intermediate points between Australia and South Africa are provided by several third-country carriers including Singapore Airlines (via Singapore), Emirates (via Dubai), Malaysian Airlines (via Kuala Lumpur), Cathay Pacific (via Hong Kong) and Air Mauritius.

3 Characteristics of the Australia – South Africa route

3.1 In the year ended 30 August 2006, traffic on the Australia – South Africa route totalled approximately 290,315 passenger movements. The average annual growth rate since the year ended August 2003 has been a moderate 3.6%. However, there was solid growth in the September 2006 year (6.8%), after a decline the previous year (-2.5%).

3.2 Of the total passenger movements, 54.0% were passengers with a destination of either Australia or South Africa travelling directly between the countries (direct traffic). Direct traffic increased by 8.3% in the year ending September 2006, compared with a decrease of 7.1% in the previous 12 months. Over the three year period, the average annual growth rate was fairly low at three percent.

3.3 Some 25.8% of movements involved passengers travelling indirectly between the two countries (indirect traffic). This has been a segment of considerable growth, averaging over 14% annual expansion over the three year period.

3.4 The remaining 20.2% of the movements involved passengers travelling between Australia and South Africa but originating in or destined for countries beyond South Africa or Australia (beyond traffic). This market segment has been falling steadily over the period.

Australia – South Africa Passenger Movements
Years Ended 30 September 2003 – 30 September 2006

Traffic category	Year ended September 2003	2004	2005	2006		Compound annual growth rate 03-06
Direct traffic (Annual % change)	143,631	155,991 (+8.6%)	144,844 (-7.1%)	156,860 (+8.3%)	(54.00%)	3.0%
Indirect traffic (Annual % change)	49,904	58,608 (+17.4%)	65,619 (+12.0%)	74,852 (+14.1%)	(25.80%)	14.5%
Beyond traffic (Annual % change)	67,872	64,188 (-5.4%)	61,358 (-4.4%)	58,603 (-4.5%)	(20.20%)	-4.8%
Total traffic (Annual % change)	261,407	278,787 (+6.6%)	271,821 (-2.5%)	290,315 (+6.8%)	(100.0%)	3.60%

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.

3.5 In the year ended 30 September 2006, visitors from South Africa slightly outnumbered Australian resident travellers on the route. Visitors from South Africa comprised 52.1% of the passenger traffic with an origin/destination of South Africa. Just over 120,000 South African visitors travelled on the route for the year, an average of 1,160 each way each week. This compared with Australian residents, who totalled 111,000 arrivals and departures, or 1,070 each way each week.

3.6 For the year to September 2006, South Africans visiting Australia did so mainly to visit friends and relatives (35%) or to holiday (33%). About 17% of South African visitors came to Australia for business reasons. Australians visiting South Africa had a similar journey purpose profile with holiday (36%) being the main reason for travel, followed by visiting friends and relatives (34%) and for business (16%).

4 Provisions of relevant air services arrangements

4.1 The Australia - South Africa air services arrangements allow the designated airlines of each country to code share on the services of the other. Qantas does not require the Commission's approval to code share on SAA's services because seats purchased by a marketing carrier do not count as a use of bilateral capacity entitlements.

5 Applicant's supporting arguments

5.1 Qantas advised that all of the conditions attached to the Commission's authorisation of code sharing have been met. The principal conditions are that:

- Qantas and SAA must operate a combined total of at least 10 return services per week between them;

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

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

5.2 Broadly speaking, Qantas considers that the code share arrangements provide an efficient use of capacity which enhance the viability of Qantas and SAA in the face of increasing competition. Substantial benefits are delivered to tourists and consumers.

5.3 Qantas observed that total origin-destination passenger traffic for the year to 30 June 2006 had increased by 8.1% over the previous 12 month period. However, Qantas stated that it continued to lose market share to third-country carriers. The combined Qantas/SAA share was 69.8% for the year ending 30 June 2006, a 3.3 percentage point fall on the previous period, despite a six percent increase in capacity operated by the two direct carriers. Qantas advised that the Qantas/SAA market share had fallen progressively from a high of 79.4% in 2002/03.

5.4 Qantas attributed this falling market share to increased competition from several third-country carriers, all of which provide one-stop services between Australia and South Africa. In particular, Singapore Airlines had increased its share from 9.2% to 13.6% in the three years to 2005/06, while Emirates' share had grown to 6.1% from 2.1% over the same period. Qantas noted that Emirates operates double daily Johannesburg – Dubai B777 services with connections to Australian gateways on 49 services per week.

5.5 Qantas stated that Qantas and SAA propose to continue their code sharing relationship on the current basis. The only anticipated change is the substitution by SAA of A340-300 series aircraft for the currently operating A340-200s. Qantas stated that it understands SAA to have no plans to commence services to Sydney and that SAA wishes to continue code sharing on Qantas' Sydney services. Qantas stated that if the code share was not re-authorised, it would not be commercially viable for Qantas to return to operating via Perth to Sydney, nor to introduce Johannesburg services terminating at Perth.

5.6 Qantas noted that the South African Competition Commission currently has the Qantas/SAA code share under review and SAA will be seeking an extension of authorisation for a five year period beyond 18 December 2006.

5.7 Qantas claimed that the code share arrangements had delivered important benefits. They had made the route profitable for Qantas and SAA, in large part through reduced operating costs, even though these gains had been partially offset by rising fuel prices. The profitability had been maintained despite increased competition from third country carriers, resulting in a falling market share for Qantas and SAA, despite them having added capacity to the route.

5.8 In addition to financial gains for Qantas and SAA, Qantas argued that the code share arrangements had delivered a range of benefits to business and leisure travellers:

- choice of carrier though the presence of both airlines in the Perth and Sydney sectors;

- operation of dedicated capacity to both Perth and Sydney;
- attractive frequency of non-stop services to Sydney, reducing travel times for east coast Australia traffic (compared with travelling via Perth under the pre-code share arrangements)
- improved product for business class passengers, as both Qantas and SAA have reconfigured their aircraft with flat-bed seats, SAA has increased business class seating, and Qantas has added a fifth service to Sydney;
- convenient connections and timings for New Zealand and domestic transfer passengers;
- price competition between Qantas and SAA on the Perth and Sydney sectors, due to the block space nature of the code share agreement; and
- maintenance of a significant Qantas presence in the Western Australia – South Africa market.

5.9 Qantas considered that the code share arrangements are delivering a superior outcome for the Australia – South Africa route, relative to the case if they were not reauthorised.

5.10 In its supplementary confidential submission, provided in response to a request by the Commission, Qantas provided detailed information on a range of matters. These included load factors, market shares, third-country passenger carriage, forward bookings, revenue yields, costs and Qantas' profits on the route.

6 Summary of submissions

6.1 The ACCC reiterated concerns expressed in its submissions to earlier IASC reviews about the competition implications of the code share arrangement between Qantas and SAA. The ACCC considered that the code share arrangement continues to reduce competition on the Australia – South Africa route. It stated that there has been no change to the situation whereby there is no competition from other carriers operating direct services. The only competition is from indirect operators. While there has been some growth in the market share of these operators, they are at a disadvantage because of their much longer travel times compared with Qantas and SAA. These comparative times were illustrated in the submission.

6.2 Further, while the code share remains, the ACCC considered it is less likely that the partners would behave so as to adversely affect their partner, such as by price discounting. There appears to be little prospect of effective competition between Qantas and SAA.

6.3 Qantas responded to the ACCC submission. Qantas stressed its view that the indirect carriers act as a significant competitive constraint on the code share partners, detailing the increased competition from these third country operators. Qantas provided examples of third-country airline fares being lower than those of Qantas and noted the rise in Singapore Airlines' market share to 13.6% in the two years to 2005/06.

6.4 Qantas argued that the Australia – South Africa market is particularly price sensitive, and this provided scope for third country carriers to capture passengers through lower fare levels and attractive accommodation offers. Further, these airlines are able to marginally price their product in the Australian market to fill otherwise empty seats on their services via their home ports.

6.5 Qantas also restated its view that the hard block nature of the code share arrangement maintains competition between the carriers including incentives for price discounting. Qantas noted that the marketing carrier manages its seat block through its own reservations system as if it operated a virtual aircraft on the route.

6.6 Qantas stated that it regularly offers special fares to increase sales or match competitors fares, including those offered by SAA. Qantas said that it had offered 10 special fare initiatives both out of Australia and out of South Africa since April 2005. Qantas also noted that it had established a simplified economy class fare structure in September 2006. The introductory level year round economy fare for Sydney – Johannesburg was $1,798 compared with the previous fare at $1,969.

6.7 The West Australian (WA) Government supported strongly the extension of the code share arrangements for a further two years. While acknowledging that there could be concerns about the level of pricing on the route, the WA Government considered these were outweighed by the risks of destabilising services to Perth in the absence of continued authorisation. The current level of Perth – Johannesburg services would be threatened and probably reduced. The WA Government therefore does not support regulatory action that would create uncertainty on the route.

6.8 The WA Government argued that significant benefits had arisen from the code share. The introduction of direct services between Sydney and Johannesburg had reduced operating costs and delivered product improvements to travellers between South Africa and east-coast Australia. Qantas had previously indicated that it would not operate to Perth, either as a stand alone service or enroute to and from Sydney, if code share approval was discontinued. The absence of Qantas on the Perth – Johannesburg sector, either through its own services or participation via code sharing, would have a major negative effect on inbound tourism to WA, almost certainly resulting in reduced frequencies on the sector, most likely to three services per week from the current five.

6.9 Any loss of service levels to Perth would also negatively affect inbound tourism to east coast Australia, through the loss of multi-destination itineraries marketed by Qantas and reduced marketing and support for WA in South Africa.

6.10 The WA Government has developed aviation objectives based on daily non-stop services to its major markets. South Africa is seen as an emerging market opportunity over the medium term and the WA Government is working with SAA with a view to eventually developing a daily schedule. The code share arrangements are seen as the best platform to achieve this over the next several years.

6.11 The WA Government considers that there is a risk of a SAA monopoly developing on the Perth – Johannesburg sector if the code share is not re-authorised. This would almost certainly result in higher prices, and reduced frequencies.

7 Commission's assessment

Assessment framework

7.1 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. As noted in Part 4 above, Qantas therefore requires the Commission's authorisation to enable SAA to code share on Qantas' services. No approval is required by the Commission for Qantas to code share on SAA services.

7.2 Under the Minister's policy statement, the Commission is normally expected to authorise applications for use of capacity to code share where this is provided for under the relevant air services arrangements. However, where the Commission is concerned that a code share application may not be of benefit to the public, it may subject the application to detailed assessment using the paragraph 5 public benefit criteria. The Commission must consult with the ACCC before doing so and has done so in this case.

Background

7.3 At its previous reviews in April 2002, May 2003 and June 2005, the Commission undertook in-depth assessments of the public benefit impacts of the code share arrangements. Detailed traffic, economic and financial data associated with the operation of the code share was evaluated. This included information about operating schedules to Perth and Sydney, aircraft types and service standards, traffic numbers on the route including seasonal patterns, the journey purpose of passengers, load factors for Qantas and SAA, Qantas revenue yields, costs and profits, and the impact of third-country carrier competition. The analyses provided the Commission with an in-depth insight into the commercial viability of the services on the route for Qantas, relative to the situation before the code share commenced, as well as its impact on competition in terms of factors such as fares, choice of carrier, frequency levels, on-board service standards and demand levels.

7.4 Analysis of the impact of the code share was clouded in the earlier reviews because of the influence of major international events, such as the SARS virus, on travel decisions. However, at its review in June 2005, the Commission found that while there had been some gains to consumers as a result of service improvement, it was concerned about high air fares and high load factors, particularly on Qantas' Sydney services. From the airline point of view, services to Sydney were proving highly profitable and Perth services had become profitable following the introduction of more efficient A340 aircraft by SAA.

7.5 Having regard to the possible tourism and consumer consequences for the level of operations to Perth if code share approval was withdrawn, the Commission authorised a continuation of the arrangements. However, as a condition of approval the Commission required the airlines to increase the number of services operated on the route to ten per week. In practice, this meant the introduction of a year-round additional weekly B747 service by Qantas between Sydney and Johannesburg from mid-December 2005. The

Commission considered that this would place some pressure on Qantas and SAA to compete to sell the additional seats.

7.6 The Commission has again carried out a detailed analysis of economic and financial route factors, using the commercial in confidence information provided by Qantas and information available to the Commission from other sources.

<u>Detailed assessment</u>

7.7 The Commission's assessment of the Qantas code share proposal against the paragraph 5 criteria in the Minister's policy statement is as follows:

<u>Competition Benefits</u>

(a) In assessing the extent to which applications will contribute to the development of a competitive environment for the provision of international air services, the Commission should have regard to:

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

7.8 The code share arrangements, which have been operating since 2000, have provided a framework that is likely to stimulate only modest competition between Qantas and SAA. The hard block nature of the code share agreement does provide some scope for the carriers to compete with each other, provided there is sufficient capacity operated relative to traffic levels to create an incentive to do so. The conditions of the Commission's approval require Qantas and SAA to price independently of each other and not to pool or share revenues.

7.9 However, where load factors are high, there is little incentive for the carriers to compete vigorously with each other. This was the situation at the time of the Commission's previous review. It was for this reason that the Commission required the operation of additional capacity from December 2005 as a condition of its continued approval of code sharing.

7.10 Load factors on the Sydney services, for which profits for Qantas were especially high, have fallen somewhat as a result of the extra year-round weekly service between Sydney and Johannesburg. This should be creating an environment to encourage greater competition between Qantas and SAA. There is at best some limited evidence that this has been the case, mainly reflected in reduced Qantas profits in the year to June 2006 compared with the previous year. Profits might be expected to be reduce somewhat further once the full year effect of the additional fifth weekly service is reflected in profit results for the 2006 calender year. However, profitability remains well above the levels of prior years during which the code share has operated.

7.11 The information provided to the Commission suggests that Qantas' yields on both its Perth and Sydney services have risen since the last review, implying higher fares (including fuel surcharges) overall. However, at the same time, Qantas' cost base has risen slightly more than commensurately with yields, largely due to higher fuel costs. Traffic levels on the Sydney sector have risen by about six percent for the year to September to 2006, while there has been a modest decline in traffic on the Perth sector. Despite the rise in traffic, as noted above Qantas load factors on the Sydney operations have fallen slightly with the additional capacity associated with the year-round fifth weekly service. Load factors on the Perth sector have been fairly stable on an annual basis.

7.12 The overall effect of these various factors has been a small reduction in profitability for Qantas on its Sydney operations, and a larger fall in profitability on Perth services. Sydney - Johannesburg is a substantially more profitable sector for Qantas than Perth - Johannesburg. However, the Commission has no information with which to assess the profitability of SAA's Perth services.

7.13 The Commission notes that there has been some growth in third-country carriers market share to about 30% of origin-destination traffic, compared with the situation two years ago. Their share of the business market is about half of this. These third-country airlines generally offer significantly lower fares for both business and leisure travel than Qantas and SAA. The lower fares are a necessary inducement to passengers to compensate for the much longer travel times associated with travel via third countries. The travel time is just over 14 hours on the direct Qantas Sydney – Johannesburg service. This compares, for example, with the quickest available Singapore Airlines flight via Singapore at over 23 hours.

7.14 Qantas and SAA are apparently prepared to accept a certain level of erosion of their market share by third country carriers. They have scope to stimulate demand through more competitive pricing than they currently engage in. Qantas has stated in its submissions that the Australia – South Africa route is particularly price sensitive. If demand on this route is unusually fare elastic, then Qantas and SAA may be able to increase profitability through lowering fares and thereby stimulating new traffic or capturing market share from third-country carriers. Aside from limited fare initiatives, there has been little evidence that they have been prepared to do so.

7.15 While third-country carriers provide some competition at the margin for Qantas and SAA, the inherent disadvantages associated with long travel times will limit their ability to gain market share beyond a certain point, even with significantly lower fares and the ability to offer packages involving a stopover. This is particularly the case for the business segment, which is comparatively insensitive to price, but more concerned about travel time.

7.16 The competitive framework on the route is further weakened because there is currently no prospect of any new entrants on the direct route. All of the capacity available under the air services arrangements between Australia and South Africa is allocated to Qantas and SAA. The absence of extra capacity also acts as a disincentive to Qantas and SAA to compete to expand the size of the market, because they cannot increase the number of their services beyond existing levels. Presently, the only scope for capacity growth is the substitution of larger capacity aircraft for existing ones. Qantas has suggested that SAA may replace the A340-200 with the slightly large 300-series aircraft, which would increase business class capacity to Perth by 50%. Should this occur, it would offer a modest competitive improvement as Qantas and SAA each sought to sell the additional seats. Qantas already operates B747s between Sydney and Johannesburg.

7.17 An important issue for the Commission is the likely competitive framework in the absence of code share approval. The Commission has previously found that there is a reasonable possibility that two separate monopolies could form on Perth and Sydney, although in theory Qantas could continue to code share on SAA's Perth services as it does not require Commission approval for this.

7.18 The Commission considers that there is little likelihood that either Qantas or SAA would change their operating patterns in a way which would enhance competitive outcomes. This is particularly the case where there is no additional frequency available to either carrier. Neither carrier is likely to be attracted to operate via Perth to Sydney, although if either or both did it could be a good competitive outcome for consumers and the tourism industry, although there would be longer travel times for Sydney passengers. There are additional costs involved in the intermediate stop. SAA is not permitted to carry domestic traffic between Perth and Sydney, so would fly partly empty aircraft between these two points.

7.19 Similarly, it is difficult to envisage Qantas dropping any of its very profitable Sydney services to serve Perth point-to-point, as it would not enable the airline to operate a satisfactory level of frequency to either port. For its part, as the WA government has suggested in its submission, SAA might reduce its frequency of operations to Perth, in the absence of marketing support from Qantas to fill these aircraft. However, with SAA's efficient A340 aircraft operating on the route, this seems much less likely than was the case when the less efficient B747s flew the route. A worst case scenario for Western Australia would involve SAA withdrawing from Perth and serving Sydney instead. This seems a highly unlikely possibility.

7.20 In summary, the Commission considers it unlikely that a more competitive arrangement would emerge in the absence of the code share while bilateral capacity on the route continues to be constrained.

Other Benefits

Tourism Benefits

(b) In assessing the extent to which applications will promote tourism to and within Australia, the Commission should have regard to:

- the level of promotion, market development and investment proposed by each of the applicants; and
- route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s).

7.21 The Australia – South Africa market has been growing at a moderate rate over the past several years, with tourist traffic to Australia making up a little over half of the total market. The balance of flows between residents and visitors over time has depended in large part on exchange rate movements between the Australian dollar and the Rand.

7.22 The most significant recent change has been modest growth in traffic on the Sydney – Johannesburg sector in the year to September 2006. This may be in part attributable to the extra capacity and choice of day of travel following from the introduction of a year-round fifth weekly service by Qantas, as was required by the Commission as a condition of continued approval of the code share. By contrast, traffic on the Perth sector weakened over the same period.

7.23 However, most of the growth in travel has been via indirect ports, which suggests that the code share arrangement is not acting as a particularly strong vehicle for the promotion of tourism to Australia. Clearly, third country carriers are capturing an increasing share of both resident and visitor travel as they provide a strong value proposition to these groups.

7.24 Withdrawal of code sharing approval may not necessarily improve the situation, for reasons discussed above, particularly if this were to cause reduced promotional support for the Perth sector by Qantas. Qantas has a significant marketing presence in South Africa. There are risks that the level of tourism to Perth on the direct services could fall.

7.25 The code share arrangement facilitates a significant amount of travel to and from behind gateway points. For example, Qantas draws traffic via Capetown to both Perth and Sydney and has connections beyond Sydney and Perth to New Zealand. “Beyond” carriage makes up a significant and important portion (about 20%) of traffic on the Australia – South Africa route, although this segment has been declining steadily over the past few years.

Consumer Benefits

(c) In assessing the extent to which the applications will maximise benefits to Australian consumers, the Commission should have regard to:

- the degree of choice (including, for example, choice of airport(s), seat availability, range of product);
- efficiencies achieved as reflected in lower tariffs and improved standards of service;
- the stimulation of innovation on the part of incumbent carriers; and
- route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s).

7.26 There has been little change to the situation for consumers since the previous Commission review in mid-2005. The most significant development was the introduction by Qantas of the fifth weekly service to Sydney, which had previously been operated only for a few months of each year.

7.27 Prior to this, the most significant consumer gain, subsequent to the code share starting, had been the introduction of the A340 aircraft by SAA to Perth in 2004, replacing old B747 equipment. This resulted in material product improvements for consumers. However, this change is likely to have eventuated in the absence of the code share arrangements. The introduction of business class sleeper seats by Qantas and SAA also represented an enhancement of service quality, although fare increases accompanied those improvements.

7.28 Importantly, there continues to be no choice of direct carrier for passengers, with a single operator to/from both Perth and Sydney. Consumers can take advantage of alternative product offerings only by travelling on third-country carriers via indirect routings. In some cases, the offer of a stopover at an intermediate point is likely to be an attractive offset to the longer travel times involved.

7.29 While the introduction of the code share arrangements generated major cost savings to Qantas and SAA, there is little evidence that this has been passed on to consumers in the form of lower fares, as discussed under the Competition criterion.

7.30 As noted above under the Tourism criterion, there are attractive possibilities to travel to and from behind gateway points within Australia and South Africa, as well as to countries beyond. However, this would equally be the case in the absence of code sharing provided frequency levels were maintained.

Trade Benefits

> (d) In assessing the extent to which applications will promote international trade, the Commission should have regard to:
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> - the availability of frequent, low cost, reliable freight movement for Australian exporters and importers.

7.31 The code share arrangements do not extend to the carriage of freight. Both Qantas and SAA are responsible for the sale of their own belly-hold capacity on their respective aircraft. However, to the extent that the code share arrangements might underpin maintenance of frequencies to Perth in particular, this would be of benefit to Australian exporters and importers.

Industry Structure

> (e) The Commission should assess the extent to which applications will impact positively on the Australian aviation industry.

7.32 The code share arrangements have had a positive impact on the Australian aviation industry through increasing Qantas' profits on the route, especially from 2004 onwards, and therefore contributing to the viability of the airline as a whole.

8 Conclusion

8.1 The Commission concludes that the code share arrangement continues to generate strong financial returns for the code share partners. The efficiency gains from the code share arrangements appear not to have been passed on to consumers in the form of lower fares. On the other hand there have been some qualitative product improvements and the addition of a year-round fifth weekly service to and from Sydney. The code share arrangement is also likely to have supported the operation of five services per week to Perth, although the introduction of much more efficient aircraft by SAA has weakened the argument that the code share is essential to the maintenance of existing service levels.

8.2 Third-country carriers provide some limited price restraint on the direct carriers and additional travel options for consumers and have been responsible for most of the growth in traffic on the route in recent years. They tend to capture a greater market share during seasonal peaks, presumably because traffic tends to “spill” from the direct carriers during these times. However, the long indirect routes flown by these carriers is likely to limit the extent of their market penetration, despite their significantly lower fares.

8.3 There is little incentive for Qantas and SAA to compete vigorously for additional traffic because there is no unused capacity available on the route, either on the Australian or South African sides. This has two effects. Firstly, there is no threat of entry from prospective new carriers. Secondly, as load factors rise, particularly during peak periods, there is no incentive to discount fares because neither Qantas nor SAA could add additional services to accommodate extra passengers. The Commission’s requirement that the airlines increase the frequency of operations on the route from December 2005 to five per week, the maximum number possible, appears to have placed only modest extra competitive pressure on Qantas and SAA. Qantas’ revenue passenger yields continued to rise in the first half of 2006 to largely offset rising costs associated mainly with higher fuel prices. Qantas’ profits, which had grown strongly in 2004 and 2005, fell slightly on the Sydney sector in the year ending June 2006, and to a greater degree on the Perth sector where traffic levels weakened a little.

8.4 Although the Commission has significant concerns about some of the public benefit impacts of the code share, it considers that there is unlikely to be a positive outcome from removing approval while there is no additional capacity available. It seems unlikely that Qantas or SAA would operate via Perth to Sydney or that either would introduce point to point services in competition with the other.

8.5 The higher probability is that removal of the code share approval, in the present capacity constrained situation, could lead to separate monopolies to Perth and Sydney and, much less probably, include a reduction in frequencies to Perth. The Commission observed in earlier decisions that the cost efficiencies associated with rationalisation of services since the start of the code share provided a basis for the continuation of services to Perth in particular. This was particularly the case while SAA operated its inefficient B747 aircraft. However, since the efficient A340 aircraft was introduced by SAA, the likelihood of a complete or even partial loss of services to Perth in the event of removal of code share approval seems most unlikely. However, two monopoly operations are most unlikely to result in an improved competitive situation compared with the current situation.

8.6 The Commission's view is that if there was extra capacity available for allocation, it would introduce the threat of new direct competition from other carriers. It would also open up other more realistic options for Qantas and SAA to service the route and to compete more vigorously with each other on Sydney and/or Perth than is currently the case in the capacity constrained environment. More competitive pricing by Qantas and SAA might have the additional benefit of "straightening up" some of the 30% of the market which currently travels via longer indirect routes. Additional services and greater price competition would be to the benefit of the public.

8.7 The Commission understands that there is a possibility of air services consultations being held between the Australian and South African aeronautical authorities in the first half of 2007. If these negotiations were to result in additional capacity being made available for operation by the carriers of both sides, the Commission considers that this would change the framework within which it has considered the code share application on this occasion. The Commission wishes to have the flexibility to review the code share arrangements again in 2007, against the possibility that there are changes to the capacity available under the air services arrangements.

8.8 In all of the circumstances, the Commission will reauthorise the code share until 31 December 2007. The Commission will maintain the existing conditions of approval of the code share, including that 10 services per week be operated. Approval of temporary reductions from this level would be considered only in exceptional circumstances.

8.9 Should substantive changes to the air services arrangements occur, the Commission would seek to encourage Qantas to apply as soon as possible thereafter for an extension, should it wish to continue code sharing beyond December 2007. The Commission would prefer to have greater lead time prior to expiry of the code share, so that the airlines have adequate time to make alternative arrangements in the event that continued approval was not granted.

8.10 The Commission will also incorporate the code share authorisation into Determination [2006] IASC 130, which renews Determination [2002] IASC 117.

9 Role of the ACCC

9.1 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.

10 Decision ([2006] IASC 225)

10.1 In accordance with section 24(1) of the Act, the Commission varies Determinations [2003] IASC 108, [2004] IASC 119 and [2005] IASC 125 to permit SAA to code share on Qantas flights operated to and from South Africa until 31 December 2007, 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 ten return services per week on the South Africa route. Temporary reductions from this level may be permitted in exceptional circumstances, but only with the prior approval of the Commission;

- Qantas must submit to the Commission reports each quarter on the number of code share seats available for sale and sold by it on each of SAA's operated services and by SAA on each of Qantas' operated services.

Dated: 11 December 2006

John Martin Chairman	Vanessa Fanning Member	Michael Lawriwsky Member