Australian Government

International Air Services Commission

DECISION

Decision:	**[2007] IASC 216**
Variation of:	**[2003] IASC 108, [2004] IASC 119, [2005] IASC 125 and [2006] IASC 130**
The route:	**South Africa**
The applicant:	**Qantas Airways Limited (ACN 009 661 901) (Qantas)**
Public Register File:	**IASC/APP/200619**

1 Brief summary of the application

1.1 Qantas applied to the Commission on 3 October 2007 to vary Determinations [2003] IASC 108, [2004] IASC 119, [2005] IASC 125 and [2006] IASC 130 to permit South African Airways (SAA) to continue code sharing on Qantas' services between Australia and South Africa until 31 December 2010. 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 [2006] IASC 225 of 11 December 2006 for the period ending 31 December 2007.

1.2 The Commission wrote on 11 October 2007 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 code share proposal. The ACCC provided a submission on 5 November 2007. Qantas responded to the ACCC submission by letter on 14 November 2007.

1.3 On 12 October 2007, the Commission published a notice inviting submissions from interested parties about the application. A submission was received from the Department of Industry, Tourism and Resources on 22 October 2007.

1.4 All non-confidential material supplied by the applicant and submitters is filed on the Register of Public Documents. The Qantas application included detailed confidential information, which was sought by the Commission in a letter to Qantas of 16 July 2007, in anticipation of the Qantas application. This confidential material is filed on the Commission's confidential register.

2 Current services

2.1 Qantas operates five B747-400 return services per week between Sydney and Johannesburg. Four of these are operated by a three-class aircraft and the fifth weekly service is flown by a two-class aircraft. Both aircraft types have "Skybed" sleeper seats in the business cabin. Qantas plans to add a Premium Economy class to four of its services by May 2008. This is an intermediate class between economy and business. Qantas advised that this category of seating would not be included in the code share agreement with SAA, as that airline does not have an equivalent product. SAA operates five A340-200 two-class return services per week between Johannesburg and Perth. A larger A340-300 series aircraft operates some services.

2.2 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 126 economy class seats on each three-class Qantas service. It buys 22 business class and 138 economy class seats on each two-class service.

2.3 Qantas advised that a number of changes are proposed by both Qantas and SAA to service levels and associated code share seat purchases. These are summarised in Section 5 below.

2.4 A considerable number of services between Australia and South Africa are provided by third-country carriers via intermediate points. These airlines include Singapore Airlines, Emirates, Etihad, Thai Airways, Malaysian Airlines, Cathay Pacific and Air Mauritius.

3 Characteristics of the Australia – South Africa route

3.1 In the year ended 30 August 2007, traffic on the Australia – South Africa route totalled approximately 318,100 passenger movements. The average annual growth rate in the three years since the end of August 2004 has been 4.3%. Growth in the past two years has been strong at 10.3% in the year ended August 2007, following 6.7% growth in the year before.

3.2 Of the total passenger movements, 53.4% were passengers with a destination of either Australia or South Africa travelling directly between the countries (direct traffic). Direct traffic increased by 9.0% in the year ending October 2007, following on from an increase of 7.2% in the previous 12 months. Qantas added a fifth weekly service in December 2005, and this may have contributed to this growth in direct traffic after a decline of 6.9% in the year ending August 2005.

3.3 About 26.2% of movements involved passengers travelling indirectly between the two countries (indirect traffic). This market segment has seen stronger growth than the direct component, averaging over 12% annual expansion for the past three years compared with 2.9% for direct traffic. In other words, the share of the market comprised of indirect traffic has been rising steadily over recent years.

3.4 The remaining 20.4% of travel on the route involved passengers originating in or destined for countries beyond South Africa or Australia (beyond traffic). This market segment showed growth in the August 2007 year after falling steadily in previous years.

Australia – South Africa Passenger Movements
Years Ended August 2004 – August 2007

Traffic category	Year ended August 2004	2005	2006	2007		Compound annual growth rate 04-07
Direct traffic	156,100	145,400	155,900	170,000	(53.4%)	2.9%
(Annual % change)		(-6.9%)	(+7.2%)	(+9.0%)		
Indirect traffic	59,100	63,900	74,300	83,300	(26.2%)	12.1%
(Annual % change)		(+8.1%)	(+16.3%)	(+12.1%)		
Beyond traffic	65,200	61,100	58,300	64,800	(20.4%)	-0.2%
(Annual % change)		(-6.3%)	(-4.6%)	(+11.1%)		
Total traffic	280,400	270,500	288,500	318,100	(100.0%)	4.3%
(Annual % change)		(-3.5%)	(+6.7%)	(+10.3%)		

Source and note: Data in this table have been derived from information supplied by the Australian Bureau of Statistics and includes 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 August 2007, visitors from South Africa slightly outnumbered Australian resident travellers on the route, although the gap in numbers closed from the previous year, continuing a marked trend that began in 2001. In 2000, there were more than twice as many visitors from South Africa as Australian residents travelling between the two countries.

3.6 In the August 2007 year, visitors from South Africa comprised 51.9% of the origin/destination traffic. Nearly 132,000 South African visitor arrivals and departures were recorded, or an average of 1,265 each way each week. This compared with Australian residents, who totalled about 122,000 arrivals and departures, or 1,171 each way each week. The visitor segment recorded growth of 8.9% over the previous year, compared with growth of 11.2% in the resident component.

3.7 The journey purpose profile of South African visitors and Australian residents is similar and little changed since a year ago. 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 showed holiday (39%) as the main reason for travel, followed by visiting friends and relatives (31%) and for business (17%). Small percentages of travellers have conventions, education and employment as their reasons for flying.

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 Detailed summary of application

5.1 Qantas summarised the history of the Commission's authorisation of the code share arrangements. The company advised that all of the conditions of approval imposed by the Commission in its December 2006 decision have been met. The principal conditions are that:

- Qantas and SAA must together operate a combined total of at least ten return services per week between them;
- the two airlines must 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 services on the route independently of SAA.

5.2 Qantas discussed changes in traffic levels and market shares on the route. It noted that there had been a 10.7% increase in origin-destination passenger numbers in the year ending 30 June 2007, compared with the previous twelve monthly period. An average of just over 2,400 origin-destination passengers travelled each way each week between Australia and South Africa in the June 2007 year. Qantas observed that this compared with an 8.1% increase in the previous twelve months period.

5.3 Qantas pointed to a further decline in the combined Qantas/SAA market share. This was 69.1% for the June 2007 year, down by 0.7% from the previous year. The market share was well below the level the two carriers held when the code share arrangements commenced in 2000, reflecting continued growth in the indirect passenger market. Qantas argued that there had been growing competition from third country carriers, which had expanded their capacity levels and used their geographical position to operate one-stop services by connecting two separate services through their home base, as well as pricing on a marginal cost basis.

5.4 Qantas listed several carriers which provided such services, noting that Singapore Airlines remains the principal third-country carrier with a market share of 12.7%, up by 3.5 percentage points since 2002-03. Qantas said that Emirates' share had grown to 6.3% from 2.1% over the same period, observing that this carrier had increased from 14 to 18 its number of weekly B777 services between Dubai and Johannesburg. These services connected with Emirates' 49 weekly services to Australian gateways. Air Mauritius had also increased its market share to 2.8% and had recently sought approvals to increase its services to Australia. Thai Airways and Etihad had entered the route in the past 12 months and Qantas expected these carriers to capture some of the Qantas/SAA market share. Thai Airways has already attracted a 1.5% market share.

5.5 Qantas stated that some changes were proposed to operations on the route and associated code share seat purchases. Both carriers will operate supplementary services over the summer peak period. Qantas would operate six additional flights with B747-300 aircraft from Sydney via Perth. SAA would purchase a 40% block on these services, consistent with the existing arrangements. SAA plans to fly an extra seven services with an A340-200 aircraft, with Qantas maintaining its block of 10 business class and 90 economy seats.

5.6 Looking to the longer term, Qantas advised that SAA planned to upgrade its services to the larger A340-300 aircraft from the Northern Summer 2008 scheduling period. This aircraft has 50% more business class seats than the 200-series aircraft it would replace. Qantas would increase to 15 from 10 the number of business class seats it buys on SAA's services.

5.7 For its part, Qantas plans to increase its operations over time to a daily service. A sixth weekly service is planned from December 2008, with the seventh service due to commence in June 2009. The additional services would offer considerable benefits to travellers. These plans are subject to the negotiation of additional capacity under the Australia – South Africa air services arrangements. Qantas has written to the Department of Transport and Regional Services (DOTARS) to emphasise the importance of this issue to Qantas.

5.8 An increase to a daily frequency would represent a 40% expansion in capacity. This was substantial, given the growth in competition from third-country carriers. In light of this competition, Qantas viewed the code share arrangements as central to sustaining its planned additional services.

5.9 Qantas stated that it understands SAA has no plans to commence services to Sydney. Similarly, Qantas intends operating to Sydney only and maintaining its Perth presence by code sharing on SAA's services.

5.10 Qantas said that the code share arrangements had provided stability on the route, increasing economic returns for Qantas and SAA, which supported their decisions to invest in growth. The improved profitability resulting from the code share, despite rising fuel prices, had underpinned Qantas' commitment to add two new Sydney – Johannesburg services over the next two years and for SAA to increase its aircraft size in 2008.

5.11 Qantas said that the code share arrangements would continue to deliver benefits to business and leisure travellers, including:

- enhanced frequency and schedule choice though the presence of both airlines in the Perth and Sydney markets, with Qantas planning to add two more services in 2008 and 2009, thus offering a daily Sydney service;

- operation of dedicated capacity to each of Perth and Sydney;

- attractive frequency of non-stop services to the larger eastern Australia – South Africa market, reducing travel times for east coast Australia traffic which previously travelled via Perth

- improved product for business class passengers, with both Qantas and SAA having reconfigured their aircraft with flat-bed seats in business class and SAA increased business class seating, with Qantas to introduce premium economy on some services in 2008;

- convenient connections and timings for New Zealand and domestic transfer passengers;
- price competition between Qantas and SAA on the Perth and Sydney sectors, resulting from the block space nature of the code share agreement; and
- maintenance of a significant Qantas presence in the Western Australia – South Africa market and SAA presence in the east-coast – South Africa market.

5.12 Qantas explained that it had sought a three-year period of authorisation because it would give the airline more certainty given its plans to add a further two frequencies to the route. Qantas would have no objection to a three year authorisation being contingent upon air services negotiations between Australia and South Africa being held in 2008 and resulting in capacity increases for Qantas.

5.13 In the confidential part of its application, Qantas provided detailed information on issues including 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 Department of Industry, Tourism and Resources (DITR) provided background information to the Commission. It said that South Africa is one of Australia's top twenty tourism markets with about 57,000 short term visitors to Australia in 2006, an increase of 8.8% over the previous year. A similar number of Australian residents visited South Africa in 2006. DITR advised that tourism to Australia from South Africa was forecast to rise to 108,000 per annum by 2016, nearly double current levels.

6.2 The ACCC noted that there was still no competition from direct carriers. The ACCC agreed with Qantas that the market share of the code share partners had decreased over the past five years. However, the ACCC noted that this share was still close to 70% and that the flying time of the indirect carriers was substantially longer than for direct flights which limited their ability to compete effectively. The ACCC cited the flying time of Singapore Airlines' flights, the largest indirect operator. It also pointed to the higher air fares on Emirates which, together with longer flying times, were likely to inhibit its impact on the code share partners.

6.3 The ACCC considered that Qantas and SAA were unlikely to operate in a way which might negatively affect their partner while the code share remained in place. This would mean continuing limited competition. The ACCC noted the increasing passenger traffic on the route over the past few years and suggested it was important to consider whether, as a result, either or both of Qantas and SAA would re-enter the sector they were not currently operating on, if the code share arrangement was absent.

6.4 Qantas responded to the ACCC. The airline Qantas emphasised its view that third-country carriers provide substantial competition on the route, with passengers willing to undertake the longer journey via intermediate points in part because it enabled a multi-destination holiday with free or heavily discounted accommodation. Qantas said that the combined market share of these carriers had increased by 10.3 percentage points since 2002/03, with a corresponding decrease in Qantas and SAA's combined share. The growth in Emirates' market share was not primarily at the expense of other third-country airlines.

6.5 Qantas also pointed to the network reach of the intermediate airlines, with their ability to offer high frequencies over their hubs and to marginally price seats in the Australian and South African markets, and detailed the services they offered. Qantas also pointed to the operations of these carriers to multiple points in Australia, enabling one stop journeys from all of these points. This somewhat nullifies the advantage Qantas and SAA have at Sydney and Perth, with their passengers from other cities having to make one stop journeys.

6.6 Qantas also contended that the hard block nature of the code share arrangements maintains competition between Qantas and SAA, with each carrier maintaining its own seat inventory and setting prices independently. The presence of the indirect carriers also ensures competitive pricing by Qantas.

6.7 Finally, Qantas referred to its plans for a daily Sydney service by the end of 2009 and that this would provide enhanced public benefits. The continuation of the code share arrangements would have a significant bearing on the medium term sustainability of these daily services and the twelve non-stop services combined to be operated by Qantas and SAA.

7 Commission's assessment

<u>Assessment framework</u>

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.

<u>Background</u>

7.3 At its previous four reviews, dating back to April 2002, the Commission conducted detailed assessments of a large amount of data on many facets of the operation of the code share arrangements so as to assess the public benefit impacts of the arrangements. These in-depth assessments covered issues such as frequency of operations to Perth and Sydney; aircraft types, configurations and service standards; traffic numbers including seasonal patterns; passenger journey purpose, load factors; trends in Qantas' revenue yields (which act as a detailed pricing proxy), costs and profits; and the extent of third-country carrier participation and its effect on competition in the market.

7.4 The effects of the code share on public benefits were difficult to ascertain in the early reviews because of the influence of events such as the SARS virus. However, at its reviews in June 2005 and December 2006, the Commission became increasingly concerned about the high air fares and rising load factors on the route, particularly on Qantas' Sydney services. Third-country airline market share had grown, but mainly as a result of traffic "spilling" from the heavily-booked direct carriers during the seasonal peaks around the end of the year. The long journey times involved in travelling on most of these carriers placed them at a competitive disadvantage relative to the direct operators, so the extent of their market growth was likely to be limited, despite offering attractive air fares. Although there had been some improvements resulting from the introduction of more efficient A340 aircraft by SAA and addition of a fifth weekly service by Qantas to Sydney, there was increasing evidence that overall public benefits were being eroded by a lack of competition on the route.

7.5 The Commission's reason for maintaining the code share, despite growing concerns about the impact of the arrangements on public benefits, was because there was a significant risk that public benefits would be lower if the code share approval was removed. The Commission was somewhat concerned about the possible tourism and consumer consequences if SAA withdrew or lessened its Perth services in response to the withdrawal of code share approval, although it considered this to be a relatively low probability outcome. There was also a significant risk that, if Qantas and SAA maintained their existing pattern of operations, separate monopolies could develop on the Perth and Sydney sectors, and such small competition as the code share arrangements offered might be reduced.

7.6 An over-arching consideration was the absence of additional capacity under the air services arrangements. This meant that Qantas and SAA, with already high load factors, had no incentive to price more aggressively to expand the market and could not introduce new services. The Commission had been hopeful that air services consultations resulting in expanded capacity entitlements might occur during 2007 and that this could be a factor in the Commission's consideration at this current review. This did not occur, although the Commission understands that the Department of Transport and Regional Services has been endeavouring to schedule such consultations.

7.7 In its current review, 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, to underpin its assessment of the public benefits associated with the code share arrangements.

Detailed assessment

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

Competition Benefits

(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.

7.9 The Commission's concerns about the effect of the code share arrangements have strengthened since the previous review in late 2006. In a growing market, with all available capacity utilised and load factors rising as a result, the hard block nature of the code share agreement is providing little more than theoretical pressure on the code share partners to compete with each other.

7.10 Rising passenger numbers (up by well over ten percent in the year to August 2007) combined with less than a five percent growth in operated seats, has resulted in very high load factors for the code share partners. Traffic on both the Sydney and Perth sectors has grown strongly. In the two years since August 2005, the number of passengers to Sydney has risen by 16%, with most of that growth occurring in the year to August 2007. On the Perth sector, there was a jump of 10% in passenger numbers in the August 2007 year compared with the previous 12 months period. There had been a slight decline in the August 2006 year over the preceding year. By comparison, operated seats to Sydney and Perth grew by 5.1% and 4.4% respectively in the August 2007 year.

7.11 Overall load factors for the two carriers (Perth and Sydney combined) in December 2006 were around 10% percentage points higher than in December 2005. This trend continued into 2007. Qantas load factors rose strongly in each of the six months from February 2007 (they were already very high in January 2006). SAA recorded sharply higher load factors through from May 2007 onwards as traffic levels on its Perth services rose strongly through that period.

7.12 During the summer peak, January in particular, the market share of third-country carriers spikes sharply, compared with the share they typically achieve over the rest of the year. This suggests strongly that it is capacity scarcity on the flights of the direct carriers at peak times which is contributing to the growth in market share of the third-country airlines, much more than the price competition which Qantas argues. Passengers who wish to travel during peak periods, but who cannot obtain a seat on Qantas or SAA aircraft, will make the much longer journey via intermediate points rather than defer travel to other times. As the Commission noted last year, the travel time differential of a minimum of nine hours is ordinarily a significant deterrent to passengers considering taking a cheaper flight on an indirect operator. With a growing market and available frequencies fully used, there is no incentive for the code share partners to compete strongly with each other, or to be overly concerned with competition from third-country carriers with their longer flight times.

7.13 The data provided to the Commission shows that Qantas' yields on both its Perth and Sydney services have remained at the high levels of the previous review. Revenues on the Sydney and Perth sectors rose as passenger numbers grew and yields were maintained. Qantas' costs on the Sydney sector increased in line with revenue growth, so profitability was similar to the very high levels of a year ago. The profitability situation on Perth improved somewhat from a year ago, as costs remained at similar levels while revenues grew. The Sydney sector generates much higher profit for Qantas than Perth, but this reflects the larger number of seats flown on this sector compared with Perth, and Qantas generating revenue only from seats it buys from SAA on the Perth sector.

7.14 Although the Commission does not have access to SAA's profit information, the higher load factors being achieved by that carrier, including solid increases on its Perth services, suggest that its services are also very profitable.

7.15 The competitive framework on the route is made weaker 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 (ten frequencies per week) is allocated to Qantas and SAA and has been fully utilised since December 2005. This means there has been no increase in base capacity operated for nearly two years, against a background of substantial market growth during that time.

7.16 The absence of extra capacity acts as a disincentive to Qantas and SAA to compete to expand the size of the market further. Their aircraft are already heavily loaded for several months of the year. The only scope for capacity growth is the substitution of larger capacity aircraft for existing ones, or the operation of supplementary services. Qantas has indicated that SAA will replace the A340-200 with the slightly large 300-series aircraft, which would increase business class capacity to Perth by 50%, but not increase economy class seating. This development would offer at best a modest competitive improvement as Qantas and SAA sought to sell the small number of additional seats. Qantas already operates B747s between Sydney and Johannesburg. Both carriers plan to fly several supplementary services over the summer peak period.

7.17 The Commission needs to determine the likely competitive outcome in the absence of code share approval, so as to assess the public benefits expected if code share authorisation was not given. The Commission has previously found that there is a reasonable possibility that two separate monopolies could form on the Perth and Sydney to Johannesburg sectors. This now seems a very likely outcome in the absence of code share approval. There would be likely to be even fewer public benefits associated with this outcome than with continuing the code share arrangements.

7.18 In theory, Qantas could continue to code share on SAA's Perth services as it does not require Commission approval for this, but this seems unlikely in practice. The Commission considers, as it did in December 2006, that neither carrier is likely to be attracted to operate via Perth to Sydney. However, if either or both did it could be a generally good outcome for consumers and the tourism industry because the number of services to Perth and/or Sydney could double, although there would be longer travel times for Sydney passengers. For the two carriers, there are additional costs involved in the intermediate stop. This option is even less attractive to SAA because is not permitted to carry domestic traffic between Perth and Sydney, so it would fly partly empty aircraft between these two points.

7.19 Similarly, it remains 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. Similar considerations apply in the case of SAA. The concerns identified in the last review, that SAA might reduce its frequency of operations to Perth, in the absence of marketing support from Qantas, are now much diminished. There has been good traffic growth on the Perth sector and SAA's load factors have risen strongly through 2007. With associated rising revenues and possibly similar cost structure to a year ago, the airline's profitability is likely to have strengthened.

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 size of the tourist market from South Africa to Australia has been growing less rapidly than the overall market over the past few years. By comparison, there has been relatively high growth in the number of Australians travelling to South Africa. These changes are likely to have been driven in large part by the strengthening of the Australian dollar from 4.4 Rand per dollar in January 2005 to 6.05 Rand per dollar in November 2007.

7.22 Much of the growth in overall 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 offer a strong value proposition to these more price sensitive groups, which enables them to capture some of the tourist market, especially in peak travel times and despite the longer travel times involved. However, withdrawal of code sharing approval under the current capacity constraints would not necessarily lead to an increase in tourism to Australia, for reasons discussed above.

7.23 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. Notably there has been some growth in this segment since the time of the last review, after it declined steadily over the previous 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:
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> - 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).

7.24 There has been little change to the situation for consumers since the previous Commission review. As noted in the Commission’s decision at that time, the most significant consumer gain, subsequent to the code share starting, was the introduction of the A340 aircraft by SAA to Perth in 2004. However, this change is likely to have occurred in the absence of the code share arrangements. The introduction of business class sleeper seats by Qantas and SAA also improved consumer benefits, although these were offset by concurrent higher air fares.

7.25 Most importantly, there continues to be no choice of direct carrier for passengers, with a single operator to/from both Perth and Sydney. This means that there is no diversity of onboard product and seat availability is often limited. Consumers can take advantage of alternative products only by travelling on third-country carriers via indirect routings. In some cases, the ability to stopover at an intermediate point would be an attractive offset to the longer travel times involved.

7.26 While the introduction of the code share arrangements continue to generate cost savings for Qantas and SAA, there is no evidence that these efficiencies have been passed on to consumers in the form of lower fares. There has been a loss of carrier choice to both Perth and Sydney as a result of the arrangements, but nothing has changed in that respect since the code share arrangements were implemented. As above, there is not likely to be any improvement for consumers if approval was to be withdrawn as the capacity arrangements currently stand.

7.27 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 the same service frequencies were maintained.

Trade Benefits

(d) In assessing the extent to which applications will promote international trade, the Commission should have regard to:

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

7.28 The code share arrangements do not include the carriage of freight. Both Qantas and SAA are responsible for the sale of their own belly-hold capacity on their respective aircraft.

Industry Structure

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

7.29 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. However, the inability of Qantas or other Australian carriers to expand services is constraining the scope for a greater positive impact on the industry from operations on the route.

8 Conclusion

8.1 The Commission concludes that the public benefits offered by the code share have weakened since its previous review in late 2006, with little incentive for the code share partners to compete with each other. The code share arrangements are generating even greater benefits for the code share carriers than was the case twelve months ago. Solid traffic growth combined with the same level of operated capacity as a year ago has seen the airlines' load factors rise strongly. A noticeable development since a year ago has been the rise in load factors in the traditionally quiet middle part of the year.

8.2 Traffic levels during peak periods were already very high a year ago, so there has been little scope for Qantas and SAA to increase the numbers of passengers carried during these periods. Despite the operation of some supplementary capacity by Qantas and SAA during the peaks, many travellers are having to travel via long indirect routings with third-country carriers in order to fly when they want to. There is a noticeable spike in third-country carriage during the summer peak periods. The Commission therefore considers that the rising level of third-country carrier market share is primarily a consequence of growing capacity constraints and does not suggest that they provide a significant degree of effective price competition for the direct carriers.

8.3 For the same reasons of growing demand and restricted capacity, combined with no threat of entry prospective new direct carriers, the airlines have been under no pressure to discount air fares to attract new traffic. Revenue yields have continued to be high as a result.

8.4 Unsurprisingly, the route continues to be highly profitable for Qantas. Sydney profits have remained at around the same levels as a year ago, as costs have risen in line with higher revenues. There was a slight increase in profitability on the Perth sector, with revenues increasing somewhat and with costs remaining at levels similar to a year ago. The fact that Qantas and SAA are losing significant amounts of traffic to third-country airlines during peak periods, due to full or near full aeroplanes on some flights - particularly to and from Sydney - means that even greater revenue potential is limited by capacity constraints rather than competitive factors.

8.5 There has been little change to the level of benefits for consumers since the previous review. The promise of premium economy class seats being introduced by Qantas is a positive step, but not relevant to consideration of the code share because such seats would be outside the code share arrangements. The introduction of the larger A340-300 series aircraft with more business class seating by SAA, means that there is scope for limited consumer gains in the future.

8.6 The code share arrangements might also have acted to support the operation of five services per week to Perth, but they now seem much less critical to underpinning these flights. Qantas has consistently maintained the position that the level of services to Perth could be put at risk if the code share approval was not maintained. However, growing traffic levels on the Perth sector and evidence of sound profits suggests that the case for the code share being essential to the maintenance of existing services to Perth is weakening considerably. It seems increasingly unlikely that SAA would abandon its commitment to Perth in the absence of the code share.

8.7 Unfortunately, although the Commission has serious concerns about the public benefit impacts of the code share it considers that, while capacity entitlements remain constrained to the current degree, terminating the current code share arrangement would be unlikely to result in a greater public benefit and may indeed create a less competitive situation. As in its December 2006 decision, the Commission's view is that the most likely outcome of withdrawal of authorisation would be the development of separate monopolies to Perth (by SAA) and Sydney (by Qantas). In this case, the very limited degree of competition between the code share partners would be lost. It is possible, but much less likely, that outcomes would develop which might lead to higher public benefits, such as Qantas or SAA operating via Perth to Sydney or either of them introducing point to point services in competition with the other. Again, however, the inability to add any further frequencies overall means that such additional benefits would be marginal at best.

8.8 Taking all of the factors into consideration, the Commission concludes that there are very slightly more public benefits from allowing code sharing to continue, compared with not doing so. The Commission will therefore vary the determination as requested by Qantas. However, the Commission does not propose to grant the extended period of authorisation sought by Qantas. Rather, it will extend the approval period for the year ending 31 December 2008.

8.9 Qantas has argued for the longer authorisation period on the basis of its commitment to add additional frequencies during 2008 and 2009. The Commission considers that any expansion of capacity under the air services arrangements would create a range of new operational possibilities for carriers on both sides. For incumbent operators, additional frequencies could, for example, increase the commercial feasibility of dedicating services to both Perth and Sydney whereas splitting the present limited number of five weekly frequencies may not be commercially attractive. Similarly, additional capacity would create an opportunity for other airlines to seek to operate on the South Africa route. Such potential changes would alter the range of scenarios that could develop in the absence of code sharing. For example, additional services, choice of carrier and greater price competition would be expected to be of benefit to the public.

8.10 The Commission considers that the Government should attach a very high priority to negotiating the additional capacity required to meet the demonstrated demand for additional direct services on the South Africa route. The capacity limitations mean that there is little or no scope for there to be an increase in public benefits, with or without the code share. The Commission would wish to see the outcome of any consultations concerning the level of capacity entitlements, before making any decisions about the code share arrangements beyond the end of 2008.

8.11 If substantive changes to the air services arrangements occur in 2008, the Commission would encourage Qantas to apply as soon as possible thereafter for authorisation of an extension of time, should it wish to continue code sharing beyond December 2008. The Commission would prefer to give Qantas maximum lead time prior to the end of the newly authorised period in which to make alternative arrangements in the event that continued approval was not granted.

8.12 In continuing authorisation, the Commission will maintain the existing conditions of approval of the code share, including that 10 services per week be operated by Qantas and SAA in total. Approval of temporary reductions from this level would be considered only in exceptional circumstances.

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 ([2007] IASC 216)

10.1 In accordance with section 24(1) of the Act, the Commission varies Determinations [2003] IASC 108, [2004] IASC 119, [2005] IASC 125 and [2006] IASC 130 to permit SAA to code share on Qantas’ flights operated to and from South Africa until 31 December 2008, 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 agreements 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: 16 November 2007

John Martin	Vanessa Fanning	Philippa Stone
Chairman	Member	Member