Australian Government

International Air Services Commission

DRAFT DECISION

Draft Decision:	**[2010] IASC 204**
Variation of:	**[2005] IASC 125, [2006] IASC 130, [2008] IASC 105, [2008] IASC 109 and [2009] IASC 126**
The route:	**South Africa**
The applicant:	**Qantas Airways Limited (ACN 009 661 901) (Qantas)**
Public Register File:	**IASC/APP/201011**

1 Brief summary of the application and background

1.1 Qantas applied to the Commission on 28 June 2010 to vary Determinations [2005] IASC 125, [2006] IASC 130, [2008] IASC 105, [2008] IASC 109 and [2009] IASC 126 to permit South African Airways (SAA) to continue code sharing on Qantas' services between Australia and South Africa from 1 January 2011 to 31 December 2012. A detailed summary of the application is set out in Part 5 below.

1.2 The Commission originally authorised code sharing between Qantas and SAA in December 2000 and has granted a series of approvals since that time. The current authorisation is contained in Decision [2008] IASC 225 of 4 December 2008 and extends until 31 December 2010. The code share agreement between the two airlines also involves Qantas code sharing on South African Airways (SAA) flights between Perth and Johannesburg. However, no approval for this is required from the Commission. Under the air services arrangements between Australia and South Africa capacity purchased by Qantas on SAA's flights does not count as an exercise of capacity by Qantas.

1.3 On 29 June 2010, the Commission published a notice inviting submissions from other interested parties about the Qantas application. The Victorian Government provided a submission on 19 July.

1.4 The Commission wrote on 1 July 2010 to the Australian Competition and Consumer Commission (ACCC), inviting its views on the Qantas proposal. The Minister's policy statement requires the IASC to invite the ACCC's views when the IASC has concerns that a code share proposal may not be of benefit to the public. The ACCC provided a submission on 20 July 2010. Qantas responded by letter to the ACCC submission on 19 August. The Qantas submission was provided on a commercial-in-confidence basis.

1.5 All non-confidential material supplied by the applicant is filed on the Register of Public Documents. Confidential information attached to Qantas' application is filed on the Commission's confidential register.

62 Northbourne Avenue Canberra City ACT Australia • Postal: GPO Box 630 Canberra ACT 2601 Australia
Tel: (02) 6267 1100 • Fax: (02) 6267 1111 • Internet: www.iasc.gov.au • Email: IASC@infrastructure.gov.au • ABN 86 267 354 017

2 Current services

2.1 Qantas operates six B747-400 return services per week between Sydney and Johannesburg, up from five weekly services at the time of the previous Commission review. Qantas noted that it will add a seventh weekly service between Sydney and Johannesburg in September 2010.

2.2 SAA operates daily A340-600 return services per week between Johannesburg and Perth. At the time of the previous review, SAA was operating five services per week and with smaller capacity A340-200 and A340-300 aircraft than the A340-600 planes now been used.

2.3 Under the code share agreement between the two carriers, SAA purchases a block of seats on each Qantas service. SAA cannot hand back these seats to Qantas, making the arrangement a “hard block” agreement. Similarly Qantas buys hard blocks of seats on each SAA service.

2.4 V Australia operates twice weekly B777-300ER services between Melbourne and Johannesburg. The carrier plans to add a third weekly service in December 2010. It has a capacity allocation from the Commission enabling it to operate a total of five services per week.

2.5 A number of third-country airlines operate between Australia and South Africa via their home nations. 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 June 2010, total traffic on the Australia – South Africa route totalled just under 358,000 passenger movements, an increase of about six per cent in the number of travellers on the route compared with two years ago. This number is made up of passengers originating in or destined for Australia or South Africa, as well as travellers on the route who have come from, or are destined for, other countries (eg. New Zealand). The modest growth in traffic levels over the past two years has coincided with the global economic downturn and a period of modest recovery from that. There is a contrast with the two years prior to this, when traffic levels increased by over nine per cent in each of those years.

3.2 The “origin-destination” traffic between Australia and South Africa totalled nearly 290,000 passengers in the year ending June 2010, or about 2,790 passengers travelling each way each week. Of these passengers, just over 72% travelled on the direct services between the two countries. This is about a four percentage points higher proportion than the direct share nearly two years ago. The change reflects growth in the direct market, but also a decline in the number of passenger travelling via third-countries between Australia and South Africa over the past two years. The remaining 28% of passengers with a destination of Australia or South Africa travelled via third-countries. The shift towards a higher percentage of direct travel is a reversal of the trend towards a growing share for indirect travel market which was evident over earlier years.

3.3 Nearly 20% of passengers travelling over the route originated in or were destined for countries beyond South Africa or Australia (through-traffic). This market segment, totalling 68,000 people, has shown little growth in the past two years, after about a 15% rise in the two-year period immediately preceding that.

Australia – South Africa Passenger Movements
Years Ended June 2006 –June 2010

AUSTRALIA - SOUTH AFRICA air passenger market							Compound annual growth rate
	Years ended June						
	2006	2007	2008	2009	2010		06-10
Direct	152,823	167,648	184,327	191,519	209,771	58.6%	8.2%
(Annual % change)		9.7%	9.9%	3.9%	9.5%		
Indirect	73,339	82,753	87,076	81,235	80,215	22.4%	2.3%
(Annual % change)		12.8%	5.2%	-6.7%	-1.3%		
Through	58,039	61,755	66,582	67,520	67,927	19.0%	4.0%
(Annual % change)		6.4%	7.8%	1.4%	0.6%		
Total Market	284,201	312,156	337,984	340,274	357,913	100.0%	5.9%
(Annual % change)		9.8%	8.3%	0.7%	5.2%		

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.

3.4 Stability in overall traffic levels disguised sharply contrasting changes in the relative number of visitors and resident travellers on the route. The number of visitors from South Africa fell by eight per cent in the June 2010 year compared with a year earlier. On the other hand, Australian resident numbers rose by 23%. This is a major turn-around from the Commission’s previous review when rapid growth in visitor traffic was a feature of the route.

3.5 The result of these dramatic changes in visitor and resident numbers is that resident travellers outnumbered visitors, reversing the position from a year ago. Residents comprised 53% compared with 46% a year earlier, while visitors made up 47% as against over 54% one year previously. In the June 2010 year, there were 136,000 visitors from South Africa, down from nearly 148,000 in the June 2009 year. About 154,000 Australian residents travelled to and from South Africa, up from nearly 125,000 a year earlier.

3.6 The journey purpose profile of visitors from South Africa and Australian residents has changed since the Commission’s previous review nearly two years ago. There has been a decline in the proportion of people travelling for business reasons, with an increase in the proportion of travellers visiting friends and relatives. However, the most significant change has been a fall-off in the number of South Africans visiting Australia for holidays, while Australian residents visiting South Africa for holidays continued to rise.

3.7 South Africans visiting Australia did so mainly to visit friends and relatives (44%) or to holiday (29%). Approximately 14% of South African visitors were in Australia for business reasons. Australians visiting South Africa showed holiday (41%) as the main reason for travel, with 35% visiting friends and relatives and 13% travelling for business. Small proportions of travellers give conventions, education and employment as their reasons for travel.

4 Provisions of relevant air services arrangements

4.1 The air services arrangements between Australia and the Republic of South Africa provide for the multiple designation of carriers. In relation to capacity, there are 14 services per week currently available to Australian carriers. This increases to 21 services per week from October 2010. The Commission has allocated five services per week to V Australia and seven services per week to Qantas. The Register of Available Capacity therefore shows that there are currently two services per week remaining available for allocation to Australian carriers for passenger services to/from Johannesburg, Capetown and/or Durban. This number will rise to nine services per week from October 2010. There is unlimited passenger capacity available for services to/from other South African points. Similarly, for dedicated cargo services, the designated airline(s) may determine the frequency, capacity and aircraft type to be operated.

4.2 The air services arrangements allow the designated airlines of each country to code share on the services of the other. Seats purchased by a marketing carrier do not count as a use of bilateral capacity entitlements. This means that Qantas does not require permission from the Commission to code share on SAA’s services. However, capacity allocated by the Commission and used by Qantas as the operating carrier between Sydney and Johannesburg is counted as the exercise of bilateral capacity. Under the *International Air Services Commission Act (1992)*, an Australian carrier may only use its allocated capacity in joint services with the approval of the Commission. Qantas therefore requires Commission authorisation for SAA to code share on Qantas’ services.

5 Detailed summary of application

5.1 Qantas said that it believed the code share arrangements maximised public benefit, involved efficient use of capacity, and enhanced the viability of the partners’ services. Loss of approval would raise average costs and reduce public benefits.

5.2 Qantas outlined the weakening of the operating environment since the code share was last authorised in December 2008, as a result of the global financial crisis, and the steps it had taken to respond to the downturn. Noting industry recovery in the first quarter of 2010, Qantas said that the industry now faced rising fuel prices.

5.3 South Africa had been caught up in the economic downturn, with an unemployment rate over 25 per cent and weaker outbound tourism contributing to a 12.2% decline in South African visitor arrivals to Australia in 2009. On the other hand, Australian originating traffic had risen by over nine per cent for the same period. Qantas noted that, against this relatively flat overall demand situation, direct seats now operated totalled just over 5,000 per week compared with 3,340 per week at the time of authorisation in 2008. The Soccer World Cup in 2010 provided a smaller than expected stimulus to tourist travel to South Africa.

5.4 Qantas then described the developments on the route since 2008 which, it said, had transformed the competitive framework. Qantas said that its and SAA's combined market share in 2009 was 74.5 per cent compared with 69.0 per cent in 2008. The rise was due mainly to the substantial capacity added by both carriers – in September 2009, SAA moved from five to seven services per week, following the substitution in mid-2008 of larger A340-600 series aircraft with up to 25 per cent more capacity than the A340-200,300 series aircraft operated previously. Qantas increased its frequency from five to six weekly services in late 2008.

5.5 However, since the end of 2009, the Qantas/SAA market share had fallen to below 2008 levels - 68.5 per cent for the first four months of 2010 - as a result of an altered competitive framework. In particular, V Australia entered the market in March 2010 and achieved nearly 15 per cent of the market in its first full month of operations in April 2010. In April the combined Qantas/SAA share was 66.6 per cent. Qantas expects its market share, particularly of business travel, to decline as V Australia expands. Qantas outlined scope for V Australia to increase its market presence.

5.6 Qantas also summarised additional initiatives by SAA to increase its market presence. SAA has an interline agreement with Virgin Blue for domestic add-on sectors. SAA also code shares with Air New Zealand for Johannesburg - Auckland services via Perth, and on Air New Zealand trans-Tasman and domestic flights, while Air New Zealand code shares on connecting SAA services beyond Johannesburg.

5.7 Qantas said that third-country carrier competition continued, with those carriers holding 25.5 per cent of the market share in 2009, although this was somewhat lower than in preceding years.

5.8 Qantas advised that it would introduce a seventh weekly service in September 2010, adding 353 seats per week to the Sydney – Johannesburg sector, a 17 per cent increase. The start of the service was deferred due to the global economic slow-down. The daily services would improve the product available to travellers. The extra service was being added despite difficult market conditions.

5.9 Qantas said that the increase in capacity from all direct carriers will be 70 per cent by December 2010 compared with the December 2008 situation. Qantas plans, from late-2011, to remove first class seats. This will see additional seats operated in a three-class configuration. Qantas argued that the code share arrangement would be instrumental in selling extra seats and in sustaining 14 weekly services by Qantas and SAA together.

5.10 Qantas referred to the competition from third-country carriers such as Singapore Airlines, Malaysia Airlines, Emirates, Cathay Pacific and Air Mauritius; established airlines operating one-stop services between Australia and South Africa. Qantas said that the combined market share of Qantas and SAA has risen only slightly (to 70%), despite traffic growth of 9.4%. The Qantas/SAA share remained below what it was in 2000 when the code share commenced and was due to the strong competition from the third-country carriers. Qantas also argued that the indirect carriers capture a relatively greater share of the overall Australia–Africa market. Qantas set out the role of each of the third-country carriers in the Australia – South Africa market, noting that Singapore Airlines was the largest participant with over 12% of the market and outlining the planned growth in services of the other third-country airlines.

5.11 Qantas then summarised the nature and history of the code share arrangements. SAA purchases hard blocks of seats from Qantas. The hard block arrangement maintains the incentive for price competition between the two carriers. They price and sell independently. Qantas said that it has offered many special fare initiatives and at times its fares are below the hard block seat price.

5.12 The South African route prior to the code share was unprofitable for Qantas. The code share had allowed the restructure of services to the current configuration. Cost efficiencies had placed the route on a sounder financial footing and produced consumer benefits. Qantas said that the large increase in capacity since 2008 meant the benefits of the code share clearly outweighed any perceived anti-competitive detriments prior to V Australia’s entry. Qantas’ extra services had been added at cost to its short to medium term profitability.

5.13 The profitability of Qantas’ South Africa services had been affected by the global economic situation, although to a lesser degree than many other routes. Profitability had declined since 2008, although it was difficult to isolate the relative effects of the economic downturn and the extra capacity now being operated by competitors.

5.14 Average fares had fallen, reflected in revenue yields reported to the Commission, with reductions in corporate travel a major cause of the decline. Qantas’ seat factors for the three-month period ending February 2010 fell by over four percentage points compared with the same period the previous year. Qantas forward bookings show a fall on those held one year earlier. Qantas’ costs had also increased and the higher expected fuel price would further affect route performance.

5.15 Qantas stated the benefits it believed the code share services had delivered, including:

- dedicated non-stop capacity to Perth and Sydney with associated tourism benefits, including promotion of these markets by SAA and Qantas;
- increased frequency and schedule choice - with daily services into both Perth and Sydney by September 2010 - with benefits to business travellers and Australian exporters;
- capacity expansion of over 40 per cent by Qantas and SAA since the Northern Summer 2008 scheduling period; and
- continuing competition between Qantas and SAA due to the block-space structure of the code share arrangements.

5.16 The continued authorisation of the arrangements would see the continuation of these benefits as well as the additional weekly Qantas service from September 2010. Qantas sought a two year extension of authorisation until 31 December 2012.

5.17 In the confidential part of its application, Qantas provided detailed supporting information on load factors, market shares, third-country passenger carriage, forward bookings, passenger per kilometre revenue yields, revenues, costs and its profits on the route.

6 Summary of submissions

6.1 Tourism Victoria's submission was initially provided on a confidential basis, but it later agreed to make the submission public. Tourism Victoria said that it had no issue with the extension of the code share agreement, but trusted it would not inhibit future development of services from Melbourne to South Africa by Qantas or SAA. A case was made for direct services on this routing. About 18,500 South African passengers travelled to or from Melbourne. There is potential for growth through immigration with increasing numbers of South African-born people residing in Victoria. Victorian exports to South Africa totalled $163 million in 2009 with a substantial proportion travelling in cargo holds of passenger aircraft. There are also strong educational links between Victoria and South Africa. Tourism Victoria noted that Melbourne's population was growing faster than Sydney's and stated that it was important Qantas and SAA did not overlook the importance of developing the Melbourne – South Africa market.

6.2 The ACCC noted that in previous submissions its concerns had arisen from the fact that Qantas and SAA were the only two direct operators on the South Africa route and were serving separate Australian points. The ACCC also suggested that the competitive dynamics of the route may have changed through the expansion of available capacity and the entry of V Australia to the route, with both Qantas and V Australia having added capacity since the expansion of entitlements under the air services arrangements. However, in the ACCC's view, third-country carriers operating via intermediate ports provided only limited competition for Qantas and SAA.

6.3 The ACCC referred to aspects of the IASC's 2008 decision to authorise continued code sharing. In particular, it noted that the IASC had assumed that V Australia would enter the Sydney – Johannesburg sector (as had been stated by V Australia when applying for capacity) and that this would deter SAA from operating on that sector if code share approval was withdrawn. However, V Australia is instead operating on the Melbourne – Johannesburg sector, which suggests to the ACCC that there is potential for SAA to enter the Sydney market in its own right if code share approval is withdrawn. The ACCC also noted remarks in the IASC's 2008 decision to the effect that extra available capacity increased opportunities for improved competition on services to and from Perth. The ACCC concluded that increased capacity had altered the competitive situation so that the need for the code sharing arrangements was likely to have lessened.

6.4 The Qantas response to the ACCC was provided on a commercially confidential basis. It addressed competition related issues and possible implications in the event that code share approval was withdrawn.

7 The draft decision of 19 August 2010

7.1 The Commission issued Draft Decision [2010] IASC 203 proposing to authorise a continuation of code sharing for a further 12 months beyond the end of the currently approved period. This would extend approval to 31 December 2011. The Commission also proposed a condition of approval that would require Qantas and SAA together to maintain a combined frequency of at least twelve services per week.

7.2 On 26 August 2010, the Virgin Blue Group announced that V Australia would withdraw from the South Africa route in early 2011. This is a significant development which alters the basis on which the Commission made its public benefit assessment in the draft decision of 19 August 2010.

7.3 A submission about the draft decision was received from an interested member of the public. The submitter argued that the loss of V Australia to the route altered the basis of the Commission's draft decision. He argued that there would be less capacity following V Australia's withdrawal and that the code share partners may have added capacity as a tactic to drive V Australia from the route. The submitter noted that the South Africa route remained profitable for Qantas, despite the effects of the global financial crisis. He said that there was no obligation for Qantas and SAA to maintain all of its capacity, noting that the Commission's draft decision required maintenance of a minimum of only twelve frequencies per week, and SAA could substitute smaller capacity aircraft once economic conditions improved on other routes. The submitter gave examples to show that Qantas' fares from Melbourne to Johannesburg were higher for travel after V Australia had left the route than during February 2011.

8 Commission's assessment

<u>Assessment framework</u>

8.1 Under section 15(2)(e) of the Act, a carrier cannot use allocated capacity to provide joint services with another carrier without the prior approval of the Commission. Qantas therefore requires the Commission's authorisation to use its allocation of capacity by SAA code sharing on Qantas' services between Sydney and Johannesburg. No approval is required from the Commission for Qantas to code share on SAA services because, under the air services arrangements, as marketing carrier Qantas is not considered to be exercising Australian capacity entitlements in that case.

8.2 When considering applications to vary determinations, the Commission must decide whether the determinations, as varied, would be of benefit to the public. The Minister's policy statement indicates that 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, under paragraph 6.4, the Commission may apply the criteria set out in paragraph 5 in circumstances where, in accordance with paragraph 3.6, it has serious concerns that a code share proposal may not be of benefit to the public. Before doing so, the Commission must consult with the ACCC and has done so on this occasion. The ACCC's submission is summarised above.

8.3 Having assessed the application, the Commission must either confirm the original determination (thereby denying approval for a continuation of code sharing beyond 31 December 2010), or amend the determination as requested by the applicant. The Commission must not vary a determination unless it is satisfied that there would be public benefit in doing so.

<u>Background</u>

8.4 The Commission has authorised code sharing between Qantas and SAA on a continuing basis since December 2000. However, the Commission has maintained short-term periods of approval of the arrangements, one or two years at a time, because of concerns about the potential for adverse public benefits to arise from them should circumstances change over the approved period. The Commission has also maintained various conditions of approval designed to encourage competition between the code share partners, such as minimum numbers of weekly frequencies which must be operated, and independent pricing. At each review, the Commission has conducted a thorough assessment of data and other information associated with the operation of the code share. This information provides the basis for the in-depth assessment called for by the paragraph 5 criteria. The material covers matters such as:

- the specific details of the code share agreement between Qantas and SAA such as seats exchanged;

- capacity entitlements available under the air services arrangements and capacity and frequency operated by Qantas and SAA including aircraft types used, seating configurations and service standards;

- trends in traffic numbers including seasonal patterns and the composition of the market including journey purpose of travellers;

- airline load factors;

- confidential financial information including trends in Qantas' revenue yields (which act as a detailed pricing proxy) and Qantas' route costs, revenues and profits, as well as its forward bookings; and

- market shares including the extent of third-country carrier participation and its effect on competition in the market.

8.5 In its reviews in 2007 and 2008, in particular, the Commission recorded its concerns about the high air fares and rising load factors on the route. However, at its December 2008 review, the Commission welcomed the major changes to the air services arrangements in mid-2008 which had resulted in a large increase in capacity available to Australian and South African carriers. Until that time, there was no capacity available for expansion by Qantas or SAA, even had they wished to do so, or for new entrants. The constrained capacity also meant that there was little incentive for the two code share partners to compete strongly through their code share blocks because aircraft were already very full. This, together with a comparative lack of competition from other carriers - there being only indirect operators participating in the market - contributed to the less than ideal situation on the route.

8.6 In continuing the code share for two years from the end of December 2008, the Commission took account of the fact that Qantas had obtained two new weekly frequencies and, more importantly, a new entrant in V Australia had also been allocated five weekly frequencies. At that time, Qantas had planned to have two new frequencies operating by December 2008 and April 2009 respectively, to add to its existing five weekly services. V Australia had indicated its intention to be fully using its capacity by October 2009, in services between Sydney and Johannesburg. The Commission was also aware that there was scope for SAA to increase frequencies to Perth above its then five weekly flights.

8.7 The Commission considered that these developments were likely to lead to substantially better public benefit outcomes, particularly once V Australia entered the route. The Commission considered that there would be no lessening of public benefits from continuing the code share for a further two years. The Commission considered that competition in the Sydney market would be particularly strong. In relation to Perth, the Commission considered that continuation of the code share might be more likely to encourage SAA to add services with the marketing support of Qantas. (As matters developed, SAA added two further weekly services in September 2009).

8.8 In concluding, the Commission considered that by the time of its next review in 2010, there should be adequate information available for the Commission to assess clearly the impact of the competitive changes that were expected to occur by that time. The Commission also noted that the presence of extra bilateral entitlements from October 2010 would also be important in the Commission's public benefit assessment of the code share for the period beyond the end of 2010.

Detailed assessment

8.9 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.

8.10 The Commission notes the requirement of the Minister's policy statement that, in considering all of the paragraph 5 criteria, the competition criterion is to be the Commission's pre-eminent consideration.

8.11 The Commission has analysed a considerable amount of data available to it to assess changes to the public benefit situation on the route since its late-2008 review. The information is comprised of statistical data, some public and some confidential, from

Government sources, such as the Australian Bureau of Statistics, and from Qantas, much of which is commercial-in-confidence, as well as some other publicly available information.

8.12 Part of the broad context for the assessment on this occasion has been the rapid levelling off of demand growth on the South Africa route after some years of strong growth. The period under review includes the global financial crisis and this appears very likely to have had a dampening effect on demand. While that crisis was underway at the time of the previous review, it was too early for any extended effects on air travel demand to be assessed. It is now apparent that the crisis appears to have had a significant effect on the South African economy, which grew only modestly in 2008, and fell into recession in 2009.

8.13 The effects of the economic downturn on air travel between the two countries began to be felt by November 2008 and continued throughout 2009 as passenger numbers levelled off or declined. Total origin-destination traffic between the two countries fell, month-on-month for nine of eleven months between November 2008 and September 2009. Modest growth began to return from October 2009 in to the first half of 2010 - although there was a decline in February - with one-off upward spikes in demand in March, April and June associated with the soccer World Cup obscuring the underlying trend.

8.14 The weakness in the market through the later part of 2008 and much of 2009 contrasted starkly with the very strong growth on the route in the period covering 2006 through to late 2008. Total passenger numbers rose by a total of about 30% over the three-year period 2006-2008. It was this rapid growth which led to the demand pressure on the constrained amount of available capacity on the route during that earlier period.

8.15 The overall demand picture disguises greatly contrasting trends in Australian resident and South African visitor travel. Every year since 1992, visitor numbers have exceeded Australian resident traveller numbers on the South Africa route, until the past year. Indeed, in the period 1998-2000, visitor numbers were about double resident numbers. From 2000 through to about 2005, visitor numbers initially declined, then stabilised before growing strongly from 2006 to 2008. By contrast, Australian resident traveller numbers have maintained a fairly steady and solid growth rate since 2000, including through late 2008 and 2009 when visitor numbers were falling. There are now more Australian residents travelling than South African visitors for the first time in nearly twenty years.

8.16 Currency changes also seem to have reinforced weakness in the South African economy in recent times in contributing to the relative shift in demand from visitors to residents. Although the trend has not been uniform, there has been a general strengthening of the Australian dollar relative to the South African Rand over the past several years. This has tended to make travel relatively cheaper for Australians going to South Africa compared with South Africans visiting Australia.

8.17 Interestingly, in terms of the flights operated by the code share partners, there was more weakness in demand on the Sydney-Johannesburg direct services, on which traffic has remained virtually at the same levels for the past two years, whereas there has been reasonable growth on the Perth-Johannesburg sector. Sydney remains the larger market at about 172,000 passengers for the June 2010 year. However, Perth has now closed the gap from about 65,000 passengers per year two years ago to about 48,000 in the year to June 2010, totalling about 123,000 passengers for the year.

8.18 It was against the background of the subdued demand situation on the route that Qantas, V Australia and South African Airways were making decisions about capacity implementation. Very substantial amounts of capacity have been added since the Commission’s previous review, although at a somewhat slower rate than was expected at that time.

8.19 South African Airways began substituting larger A340-600 aircraft for the smaller capacity A340-200 and 300 series aircraft in the middle of 2008. It added two new weekly services from September 2009. Qantas added a sixth weekly B747 service from mid-December 2008, as planned, but deferred the planned implementation of its seventh weekly service from April 2009 to September 2010. In March 2010, V Australia commenced twice-weekly B777-300ER (361 seat) services between Melbourne (not Sydney from October 2009 as the Commission understood would be the case at the time of the 2008 review) and Johannesburg. V Australia deferred implementation of its remaining three allocated frequencies. It had planned to add a third weekly service in late 2010 and then two further frequencies as market conditions improved. However, as noted above, V Australia announced in late August 2010 that it would cease operations on the route in February 2011.

8.20 The addition of substantial extra capacity by the code share partners (and V Australia) has created a situation which contrasts starkly with the situation in mid-2008. At that stage, regular weekly frequencies had remained fixed since late 2005 with the little supply growth in that period coming from the use of supplementary services in peak times and substitution of larger capacity A340 series aircraft for smaller series planes at various times. This constrained supply was occurring against the background of rapid traffic growth.

8.21 As a result, by the middle of 2008, load factors were extremely high, exceeding 90% for Qantas over several months of the year. Load factors were also seen to be rising even over traditionally quiet months of the year. The Commission observed that a significant number of passengers were travelling on third-country carriers, despite much longer travel times, and that this third-country share tended to rise at peak times. It appeared to the Commission that this effect may well have been due to the inability of passengers to find seats available during the seasonal peak months which, by that stage, had extended over the five months from December to April. There may have also been fare differential effects at work, with lower fares offered by third-country carriers helping to induce passengers to fly on these services.

8.22 The Commission found at the 2008 review that air fares were high, reflected in high passenger revenue yields reported by Qantas to the Commission. Capacity constraints on the direct carriers meant that aircraft could be filled easily and there was little incentive or scope for Qantas and SAA to compete with each other through discounting fares to generate additional traffic or increase market share relative to each other or third-country carriers.

8.23 The lack of capacity was undermining the scope for competition between Qantas and SAA which the hard block nature of the code share should create. Hard block arrangements are generally more competitive than free-sale type arrangements, because they create an incentive for the code share partners to maximise revenue to cover the fixed costs of the blocks they have purchased from each other.

8.24 The lack of competition was apparent in continuing substantial profit margins for Qantas on the South Africa route in 2008, with a modest decline in profitability of services on the Sydney sector more than offset by better profit from the Perth services. Increased costs for Qantas were more than compensated for by rising revenue yields, as seen in higher air fares. The route as a whole continued to be very profitable for Qantas. The Commission noted that publicly available information indicated that SAA's previously very poor financial situation had improved somewhat following restructuring and that its Australian services had contributed to this.

8.25 Although the public benefits from this situation were poor, the outlook was more positive and removing the code share would not necessarily result in any improvement in public benefits. The Commission therefore continued code share authorisation until the end of 2010, indicating its expectation that public benefits would rise as planned new capacity was introduced through late 2008 and into 2009, and particularly with the addition of a new competitor in V Australia.

8.26 The analysis of the data now available to the Commission for the period since the December 2008 review shows that public benefits have indeed improved greatly since that previous review. Although overall capacity and frequency growth has been less than expected at that time, it has still been in the order of 50% above the capacity and frequencies then being operated. This is a large increase in less than two years, particularly against the background of little growth in traffic on the route, as discussed above.

8.27 The data on Qantas' passenger revenue yields available to the Commission indicates that price competition had intensified dramatically well before V Australia's entry in April 2010. Qantas' yields fell substantially in 2009, relative to 2008 when yields were at very high levels. It seems clear that this improved competition was driven by the substantial addition of capacity by both SAA and Qantas into a market in which travel demand had weakened as a result of the subdued South African economy. Qantas and SAA were motivated to compete much more vigorously with each other and third-country carriers.

8.28 The entry of V Australia has clearly provided a further competitive stimulus. Although V Australia has entered the Melbourne – Johannesburg sector rather than Sydney – Johannesburg sector as planned, its entry has clearly created stronger competition and better public benefit outcomes.

8.29 The Commission suggested in its August 2010 draft decision that early indications were that V Australia's entry to Melbourne had been successful, with the airline achieving solid load factors in its first few months of operations. Although start-up losses are to be expected on a new route, the Virgin Blue Group's announcement that the services would be terminated in early 2011 imply that it did not believe the services would eventually generate a sufficient return to warrant their retention. This is an unfortunate development from a public benefit perspective as V Australia's entry has delivered substantial public benefits. Its presence in Melbourne has created non-stop services for travellers in the Melbourne – Johannesburg market segment for the first time in the history of air services between Australia and South Africa. Previously travellers to and from Melbourne had to use domestic services to connect either with Qantas services from Sydney or SAA services from Perth. The direct services therefore mean improved convenience and reduced travel time for Melbourne passengers. It also gives these travellers improved product differentiation and choice.

8.30 V Australia's presence also means a new choice of carrier for Australians living on other parts of the east coast. However, there is longer travel time for connecting Australian passengers from points north of Sydney compared with travelling via Sydney. In addition to extra domestic travel time, V Australia's Melbourne flights take longer than Qantas' Sydney services by just over an hour eastbound and somewhat more westbound. There are some operational restrictions on the flight path which can be flown by V Australia's twin-engine B777 aircraft, related to maintaining a minimum flying time from alternate airports, which mean that its flights do not travel on the shortest possible route. This increases V Australia's costs. However, the different point of origin of Qantas and V Australia services creates incentive for both of them to compete with each other for feeder traffic to and from Australian domestic points. Qantas needs to compete strongly on price to attract other gateway traffic, especially Melbourne, while V Australia needs to do the same to attract Sydney and other gateway traffic.

8.31 There is clear evidence this is occurring. For example, analysis of available Qantas ex-Australia economy fares for Melbourne – Johannesburg travel for coming months shows they can be around fifteen percent cheaper than on its Sydney – Johannesburg flights for travel at the same time of the year. Its fares to and from Melbourne are often lower than those offered by V Australia. These differences are despite the extra cost of carrying Melbourne passengers on the domestic sector to and from Sydney.

8.32 V Australia's Melbourne and Sydney to/from Johannesburg economy fares are generally similar, again despite the extra cost of the domestic sector to and from Melbourne. Its Sydney fares for outbound travel are often lower than Qantas Sydney fares, but at times higher for inbound travel. Brisbane passengers are also well served, with Brisbane fares to and from Johannesburg via Melbourne also being very similar to those available ex-Melbourne.

8.33 There is a bigger gap in business class fares, with V Australia's return fares from Sydney being $1,700 to $2,600 cheaper than Qantas. V Australia's ex-Melbourne business class fares are also substantially lower than those offered by Qantas.

8.34 This evidence tends to suggest that the most significant public benefit from V Australia's presence is likely to be its impact on air fares. Unfortunately that benefit will not continue once V Australia leaves the route in early 2011.

8.35 The Commission notes that fare levels in the actual period of operation by V Australia up to June 2010 were distorted because of the effect of the soccer World Cup in South Africa. The World Cup provided carriers with a captive market of relatively price-insensitive travellers, compared with the usual leisure travel segment. That airlines were able to exploit this is evidenced in Qantas' passenger revenue yields in May and June 2010, which were considerably above yields for the corresponding months one year earlier. However, as noted above, evidence from Qantas yields shows that price competition was much improved well prior to V Australia's entry and fares available for travel in future months shows that competition on fares continues to be strong. This is likely to continue at least until V Australia leaves the route, after which a moderation of price pressures will occur.

8.36 The extent to which this happens is likely to be influenced significantly by the rate at which traffic levels recover and the rate at which the incumbent carriers add capacity. An important driver of demand growth will be the rate at which economic recovery occurs in

South Africa. The outlook is uncertain, although indications are that South Africa is likely to experience modest economic growth through the rest of 2010 and 2011. If this occurs, and the Australian economy remains robust, traffic levels can be expected to increase, although the extent of any rise is difficult to gauge.

8.37 As the Commission noted in its August draft decision, further evidence of an improved competitive situation is provided through market share data. In the year ending May 2010, V Australia had captured nearly four percent of the market for the year, from only two and a half months of operations. Qantas market share for the May 2010 year lifted slightly over the previous year, to around 42 per cent while SAA's market share fell very slightly to around 29 per cent for the May 2010 year. The market share of third-country airlines has fallen by about three to four percentage points from the situation two years ago. It seems likely that better availability of direct seats and lower prices offered by direct carriers has seen a "straightening up" of Australia – South Africa traffic.

8.38 Obviously any market share which V Australia garners over coming months will be returned to the code share partners and third-country carriers when V Australia leaves the route in February 2011.

8.39 Another very positive development is the significant reduction in load factors on the Sydney and Perth services of Qantas and SAA respectively following the addition of capacity by them both and with subdued levels of demand since. The average load factor across all Qantas and SAA services combined was about 73 per cent in the year to June 2010. This compares with the situation for the June 2008 year when the combined average load factor was about 82 per cent. There was a bigger relative fall on the Perth – Johannesburg sector, reflecting the greater proportional increase in capacity there compared with Sydney. Average load factors for the June 2010 year were a little under 80 per cent for the Sydney services and about 66 per cent for Perth services. Lower load factors give passengers a better sense of comfort and space on board the aircraft and there is better seat availability when looking to purchase a seat. The improvement in load factors was evident well before the entry of V Australia, although V Australia's presence will be acting to keep Qantas and SAA load factors lower than they would otherwise be.

8.40 Load factors on the code share partners' services can be expected to rise with the loss of the twice weekly V Australia services as passengers switch back to the Qantas and SAA services. However, as noted, the Perth service load factors are low, so a modest rise in these is unlikely to cause a significant loss of amenity on those services in the near future. The expected rise in load factors on the Sydney services will be moderated by the extra weekly B747 service to be added by Qantas in September 2010, although space on the Sydney services is likely to come under pressure in seasonal peak periods. Fortunately, as noted above, V Australia does not leave the route until late in the coming summer peak period.

8.41 One other interesting and important pro-competitive development has been the interline agreement between SAA and Virgin Blue which was implemented in April 2009. This arrangement is likely to encourage stronger price competition between Qantas and SAA for traffic behind the Perth gateway travelling on SAA's Perth-Johannesburg services, and on SAA services beyond Johannesburg. This occurs because the arrangement puts SAA on a more equal footing with Qantas in its ability to feed traffic to and from the Perth services. The growth in traffic on SAA's Perth services relative to the flat demand on Qantas' Sydney services may be due in part to the impact of this new arrangement. SAA has also entered into a code share agreement with Air New Zealand, which gives it improved access to traffic flowing to points behind the South African and Australian gateways served by SAA. The Commission understands that these arrangements will continue following the withdrawal of V Australia from the South Africa route, maintaining an important additional competitive element between Qantas and SAA.

8.42 Finally, it is evident that Qantas' total revenues on both sectors were affected by lower revenue yields, even as passenger numbers rose slightly. Again, this development was in evidence well before V Australia entered the route.

8.43 Taken together, the evidence discussed above indicates to the Commission that the public benefit situation on the route has improved from the situation which has prevailed for a number of years. Unfortunately public benefits on the route are likely to be eroded by the departure of V Australia from the route. However, the assessment the Commission must make is whether there is likely to be any lessening of public benefit from allowing the code share to continue, compared with the most likely counterfactual scenario. Clearly those alternative scenarios now do not include V Australia's presence beyond February 2011.

8.44 Despite the loss of V Australia, the Commission considers the most likely scenario to be that neither Qantas nor SAA would significantly change their operating patterns, if at all, if code share approval was withdrawn, at least for some time. The market dynamics have altered somewhat since late 2008, when the Commission saw a reasonable possibility that the two carriers would change their operating patterns, had V Australia's entry to the market not been imminent.

8.45 Overall demand growth has been slow in the past year and a half. However, from SAA's point of view, the Perth market has continued to grow relative to Sydney, and is now over 70 per cent of the size of the Sydney market. SAA has committed itself strongly to Perth, having moved from five services per week to daily flights in September 2009, a development that was not known at the time of the Commission's previous review. SAA has also substituted larger capacity A340-600 series aircraft for smaller capacity models. SAA also now has much improved scope to attract east-coast traffic by virtue of its interline arrangement with Virgin Blue, increasing competitive tension with Qantas for traffic to and from other Australian points, with the need for SAA to have an operating presence.

8.46 SAA appears to be still in a recovery phase from a very weak financial situation. It incurred a loss of nearly 1.1 billion Rand in 2007/08 (about $167 million at current exchange rates), following an R883 million loss in 2006/07. It returned a modest R398 million profit (about $58 million) in 2008/09 after a major restructuring program. SAA's financial statements make it clear that the airline aims to work hard to remain profitable on a sustainable basis. The airline's 2009/10 financial results are not yet available.

8.47 Given all of these factors, SAA seems unlikely to commit to the risk and costs associated with new services to Sydney in direct competition with Qantas in the near future. SAA does not have traffic rights to carry domestic passengers between Perth and Sydney so flights to Sydney via Perth and vice versa would have many empty seats on the domestic legs. SAA would also be looking to continue to develop the Perth market to lift the modest load factors on its services and so has incentive to price competitively to achieve this, both for Perth traffic but also other Australian cities, even after V Australia's departure. If SAA did not introduce Sydney services in response to a loss of code share approval, the improved competitive tension which now exists between SAA and Qantas through their hard blocks in the code share would be lost. It would leave Qantas as the only provider from that gateway. If this was to occur, it is likely to lead to a considerable decline in public benefits relative to the code share continuing.

8.48 From the Qantas perspective, that airline has committed to the introduction of a seventh weekly service on the Sydney – Johannesburg sector and is likely to focus its efforts in strengthening those services which, thus far, appear to have been somewhat weakened by the ability of V Australia and SAA to attract passengers to and from other Australian points onto their South African services. Qantas could in any event continue code sharing with SAA on the Perth sector without Commission approval, if SAA was agreeable to such an arrangement in the absence of authority to code share on Qantas' Sydney services. Qantas appears to have a commercially attractive agreement with SAA on the Perth code share services and is unlikely to prefer to incur the additional costs of routing its Sydney services via Perth, or of starting new stand-alone Perth services.

8.49 Even if Qantas was to introduce directly competing services with SAA on the Perth sector, it is questionable whether there would be the additional public benefits which the Commission considered likely at the time of the previous review. This is because the code share arrangement now appears to be delivering good competitive outcomes as a result of the substantial increase in capacity available from Perth, with two extra weekly flights and aircraft with increased seating capacities. This situation is likely to prevail for at least some time, even though whatever threat of entry by V Australia on the Perth sector that might have prevailed until recently, appears now to be extremely low.

8.50 The improved public benefits arising from the code share since the previous Commission review, evident well before the entry of V Australia, inclines the Commission towards granting the code share partners the benefit of the doubt in terms of a continuation of approval. The Commission concludes that it is unlikely that there will be any lessening of competition benefits from continuing the code share for a further limited period, given the relatively subdued demand outlook, recent capacity increases and the imminent addition of more capacity by Qantas from Sydney.

<u>Other Benefits</u>

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).

8.51 At its review in late 2008, the Commission suggested that the forthcoming introduction of additional capacity and a new airline was likely to stimulate increased fare competition and promotional activities from airlines. This was likely to contribute to supporting tourism from South Africa. An increasing proportion of the market was expected to travel on direct flights. The Commission considered that withdrawal of code sharing approval was unlikely to lead to a further incremental increase in tourism to Australia.

8.52 The structural changes predicted by the Commission have occurred. Extra capacity was added including by a new entrant to a new point, with associated marketing effort, and there was greatly improved pricing. However, as discussed above, the tourist market from South Africa to Australia has fallen since the time of the last review, in line with a weakening of the South African economy through the global financial crises. The number of visitors travelling for holiday fell from about 24,000 in 2008 to about 18,000 in 2009. This contrasts with the period leading up to the previous review when there was strong growth in visitor arrivals for holiday purposes in each of several successive years.

8.53 Clearly the weak economic situation in South Africa was not able to be offset by more competitive circumstances on the route, leading to the fall in visitor numbers. The decline in business and employment-related travel from South Africa confirms the effect of weakness in economic circumstances on tourist visitation to Australia. By contrast, the relative strength of the Australian economy meant that the more competitive situation on the route was able to stimulate growth in Australian resident travel to South Africa. This suggests that without the improved competitive situation on the route, tourist visitor numbers may well have fallen further than they did.

8.54 Overall travel via third-countries weakened compared with travel via direct services. As discussed above, this situation appears to be due in large part to better seat availability and more competitive pricing on direct services compared with two years ago. However, although the market share of third-country carriers has declined, these operators continue to capture a significant share of the tourism market and provide a modest level of competitive pressure on the direct carriers.

8.55 There are attractive options to travel to and from behind-gateway points within Australia and South Africa, as well as to countries beyond. There has been no material change in the Qantas/SAA behind-gateway arrangements, which provide good connectivity to international destinations behind the Australian and South African gateways.

8.56 Improvement in recent times has come from new arrangements outside the Qantas/SAA code share agreement. V Australia’s entry has improved the situation with the ability of Virgin Blue to feed tourist traffic to and from V Australia’s services. New Zealand traffic can also use Pacific Blue Australia’s trans-Tasman flights to connect with V Australia’s Melbourne services. The new code share arrangement between SAA and Virgin Blue has also improved the behind gateway feed to and from SAA’s Perth services. SAA’s new arrangements with Air New Zealand have also improved its ability to compete for through-international traffic.

8.57 The Commission is satisfied that there is no lessening of tourism benefits from the Qantas/SAA code share arrangements from the code share arrangements. Improved competitive tension has placed more pressure on the code share carriers to market and promote their services. Similar marketing, promotional efforts and behind gateway availability would be likely to prevail in the absence of the code share.

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).

8.58 There has considerable improvement in the situation for consumers on the South Africa route. As discussed above, the introduction of V Australia's services provides a new choice of carrier and gateway. Extra capacity provided by Qantas and SAA under the code share arrangement has also greatly improved choice for consumers, with additional choice of day of travel from Perth (now daily flights) and from Sydney (a sixth weekly service with a seventh to be introduced in September 2010). The expansion of entitlements under the air services arrangements in 2008 has opened the way for a transformation of the structural situation on the route, greatly improving benefits for consumers.

8.59 Although the code share partners have not opened up any new direct gateways, as noted above, SAA has improved its beyond-gateway connections. Qantas and SAA have significantly reduced average tariff levels and there is better seat availability with lower load factors as well as the choice of extra days of travel from both Perth and Sydney.

8.60 As the Commission anticipated in its 2008 decision, consumer benefits have increased substantially with V Australia's entry, both through the additional choice this brings, and also through the competitive responses of Qantas and SAA. The departure of V Australia in February 2011 will result in a decline in consumer benefits but this occurs independently of any decision about continuation of the code share. Given the greatly improved capacity and competitive situation between Qantas and SAA, the continuation of the code share is unlikely to lead to a lessening of consumer benefits relative to removing approval for some time to come at least.

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.

8.61 The code share arrangements exclude the carriage of freight. Qantas and SAA are each responsible for the sale of belly-hold capacity on the services they operate.

Industry Structure

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

8.62 The code share arrangements have had a positive effect on the Australian aviation industry by increasing Qantas' profits on the route, especially in relation to Perth. The cost saving they have generated appear to have assisted the ability of Qantas to add extra services. The expansion of services, supported by the code share, positively benefits Qantas itself, as well as benefitting ancillary aviation businesses which are integrated with Qantas' operations.

9 Conclusion

9.1 The Commission concludes that the public benefits associated with the code share have improved dramatically since the previous review in 2008. There is a new carrier operating from a new Australian gateway, the incumbent carriers have increased capacity substantially, air fares have declined sharply particularly for travel to and from the Australian east coast (except for a jump associated with the soccer World Cup) and load factors have eased, especially on the Perth sector. Further capacity is scheduled to be added by Qantas in September 2010.

9.2 Looking beyond early 2011, when V Australia ceases services, the route is likely to be less competitive than would have been the case if V Australia had continued flying as the Commission anticipated would occur when it issued its 19 August 2010 draft decision. This means that public benefits are likely to be reduced once V Australia ceases operations. However, this of itself is not a basis for denying continued code share approval. The issue for the Commission is to determine whether, in the context of an altered competitive framework in V Australia's absence, there would be a lessening of public benefit from a continuation of the code share.

9.3 For similar reasons outlined in the 19 August 2010 draft decision, the Commission considers that there is unlikely to be a lessening of public benefit from continuing the code share for a further period. As the Commission noted above, there was clear evidence of improved public benefits through 2009 following the addition of extra capacity by Qantas and SAA, well before the entry of V Australia. This suggests that, where there is ample capacity operated by Qantas and SAA, public benefits will be higher compared with a capacity constrained situation such as prevailed until late 2008.

9.4 The Commission's concern is that Qantas and SAA will be tempted, in the absence of V Australia, to allow capacity to become constrained as economic recovery leads to a return to demand growth on the route. As noted in the August 2010 draft decision, faster than expected economic recovery could place upward pressure on demand and lessen competitive pressures on the carriers. Although Qantas' forward bookings are generally fairly subdued, they only cover a period within the existing authorisation to the end of 2010. The loss of two weekly V Australia services and addition of only one weekly Qantas service is likely to see load factors on the Sydney services begin to rise. Fortunately, as previously noted, V Australia does not leave the route until towards the end of the summer peak season.

9.5 It is clear from past history that the code share partners are not slow to take advantage of situations where demand is rising and capacity is constrained. It is evident that competition between the two code share partners will only persist while there is incentive for both of them to fill seats on both the Sydney and Perth services. The Commission will therefore monitor closely the development of traffic levels and capacity plans of Qantas and SAA over the months through to mid-2011 and the pricing behaviour in which they engage through that time. Neither carrier is limited in its capacity expansion by bilateral constraints, so any future capacity suppression could arguably be interpreted as a desire to reduce costs and drive up fares. The Commission's sampling of fares now available for sale for travel on

Qantas’ services in the months following the departure of V Australia are not encouraging from a public benefit point of view.

9.6 The Commission proposes to vary the relevant determinations to authorise the continuation of code sharing sought by Qantas beyond the current period, which ends on 31 December 2010. However, for the reasons outlined above, the Commission proposes extending the period of authorisation only until 31 December 2011.

9.7 To protect against the two carriers deciding to reduce capacity, particularly now that V Australia is leaving the market from February 2011, the Commission proposes to include a condition requiring Qantas and SAA to maintain a minimum of 14 services per week between them. This is an increase of two frequencies from the proposed conditions in the August 2010 draft decision and an increase of four frequencies from the Commission’s December 2008 decision. The Commission also expects that SAA would not substitute smaller capacity aircraft for its A340-600 services. Were it to do so, this would be a relevant factor in the Commission’s consideration of a request for a further extension of the code share.

9.8 The Commission expects that Qantas will apply by 30 June 2011 for any further extension of the code share. If, by the time of the next review in mid-2011, there is evidence that the public benefit indicators have turned down, the Commission is likely to be very inclined towards not granting a further extension of code share approval beyond 2011. The code share partners may therefore wish to consider carefully their capacity expansion plans and pricing behaviour in the period following the departure of V Australia.

9.9 Given the altered situation following V Australia’s decision to withdraw from the route, and the Commission’s intention to increase the minimum number of frequencies Qantas and SAA must maintain, the Commission will issue a second draft decision and invite interested parties to respond to it.

10 Role of the ACCC

10.1 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.

11 Draft Decision ([2010] IASC 204)

11.1 In accordance with section 24(1) of the Act, the Commission proposes to vary Determinations [2005] IASC 125, [2006] IASC 130, [2008] IASC 105, [2008] IASC 109 and [2009] IASC 126 to permit SAA to code share on Qantas’ flights operated to and from South Africa until 31 December 2011, 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 and SAA must price and sell their 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 fourteen 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; and its quarterly yields per revenue passenger kilometre for all passenger classes on these services.

Dated: 9 September 2010

Ian Smith	Stephen Bartos
Member Presiding	Member