



INTERNATIONAL AIR SERVICES COMMISSION

Your ref: C2002/1774

Mr Tim Grimwade
General Manager
Adjudication Branch
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Mr Grimwade

Trade Practices Act 1974
**Applications for authorisation lodged by Qantas Airways Limited,
Air New Zealand and Air Pacific**

Thank you for your letters of 19 December 2002, 7 January 2003 and 28 January 2003 inviting submissions in relation to applications for authorisation made to the ACCC by Qantas, Air New Zealand and Air Pacific, including proposed undertakings offered by the parties in relation to the Strategic Alliance Proposal. I should note at the outset that no application has yet been lodged by Qantas for codesharing approval in connection with the application to the ACCC. The IASC notes that the Strategic Alliance Proposal includes agreement to allow Air New Zealand to code share on any sector flown within the Qantas New Zealand network, as well as on Qantas' non-JAO sector flights that reasonably connect to flights on the JAO network. Approval for such codesharing on routes to Australia is required pursuant to Section 15(2)(e) of the *International Air Services Commission Act 1992* (the IASC Act).

Consistent with the IASC's approach in submissions to previous cases involving aviation authorisation applications, the Commission does not propose to comment in detail on the merits of authorisation or otherwise of the Strategic Alliance Proposal or the acquisition by Qantas of shares in Air New Zealand. Nevertheless, there are a number of observations that the IASC would wish to make about the airlines' proposals, and about the IASC's decision making processes, including how they relate to the ACCC's decision making path in this case.

The scope of the proposed arrangements for which authorisation is sought is extensive and far reaching, involving a high degree of co-ordination and control over all aspects of the economics of the services to be provided. This includes fare setting, capacity and routes to be operated, as well as co-ordination of matters such as product

development and control of product distribution and agency relations. The arrangements are also substantial in their scale, applying to some of Australia's largest international markets – the trans-Tasman in particular, but also the United States route in relation to services operated by Air New Zealand.

The arrangements, if implemented, can be expected to have significant effects on current and future competition on the routes involved, particularly the major JAO routes. The IASC notes that the parties have provided an analysis prepared by the Network Economics Consulting Group aimed at estimating the economic cost of the anti-competitive nature of the arrangements. The analysis also quantifies a range of public benefits expected to offset these costs. The IASC notes that the estimates of costs and benefits are predicated on significant assumptions, such as the entry of Virgin Blue on to trans-Tasman routes and the possible effects on Air New Zealand if the arrangements are not authorised. The ACCC will no doubt carefully test the assumptions underlying the analysis in evaluating the benefits claimed. For example, at this stage, whether or not and when Virgin Blue might enter trans-Tasman or other routes is unclear.

In the context of the ACCC assessing the public benefit impact of the proposals, the IASC notes that the alliance partners have now proposed undertakings designed to limit certain competitive actions by them so as to protect scope for new entry. It would be a matter for the ACCC to assess the extent to which the undertakings proposed may reduce the anti-competitive effects of the alliance arrangements. Obviously, the stronger any final undertakings are in preserving scope for competition, the lesser the detrimental impact on public benefit of the arrangements is likely to be. The IASC notes that the undertakings as they currently stand appear to be vague in several respects and open to interpretation.

Clearly, the eventual terms and conditions of any authorisation by the ACCC of the proposed conduct will affect the extent to which competition, and/or scope for it in future, is maintained. These will in turn be important in the IASC's consideration of any application by Qantas to code share. The IASC's approach will be to evaluate the composite of the proposed arrangements and the undertakings (as hopefully may be made more certain after discussion with the ACCC) rather than the proposed arrangements in isolation. To express this in another way, the IASC will not merely assess the proposed arrangements and leave the undertakings as conditions of approval (assuming ACCC approval is to be given) between the applicants and the ACCC. You may wish to note that proposed code sharing by Qantas on Air New Zealand services does not require approval by the IASC, where this does not involve an exercise of Australian capacity entitlements by Qantas. However, the IASC notes that such activities would be relevant to the ACCC's overall consideration of the alliance proposals.

As the IASC has not as yet received an application from Qantas to code share with Air New Zealand in relation to the proposals set out in the ACCC authorisation application, the IASC will shortly be writing to Qantas to suggest that it should apply in the near future. This will enable the ACCC and IASC to work towards making their respective decisions on the same or similar timetables, thereby speeding up the regulatory decision making process. Such an approach should also provide greater certainty for Qantas and the other alliance parties. The IASC would expect to be included in any application argument as to how currently approved code share arrangements will be affected by the arrangements for which ACCC authorisation is being sought. It is desirable that Qantas applies soon, as the IASC Act requires advertising of any application and the consideration of public comments and the time requirements for these steps need to be kept in mind.

One of the aims of the co-operation arrangements between the ACCC and IASC is to facilitate consistency of decision making where responsibilities overlap. As you know, the IASC has in the past taken account of authorisations given by the ACCC which provide an umbrella for routes on which Australian carriers have subsequently sought IASC authority to code-share. This approach has provided consistency for carriers where, as in these sorts of cases, approvals from both the ACCC and the IASC are required for code sharing to be conducted.

However, it needs to be kept in mind that the current application being considered by the ACCC is far more wide ranging than would be a code share application to the IASC, and each Commission is obliged to consider applications against their respective legislative framework. In the IASC's case, each code share application is considered on its merits, in accordance with the IASC Act and the public benefit criteria set out in the Minister's Policy Statement. The different considerations involved for the two bodies necessarily mean that approval or rejection by one cannot automatically imply the same decision by the other. However, as stressed above, as far as possible within the respective frameworks it is desirable if a consistent outcome is achieved.

In relation to the IASC's particular approach to a code sharing application involving Qantas and Air New Zealand, some code share cases considered by the Commission over the past year or so may provide some guidance. These cases involved significant code share proposals from Qantas in relation to the Japan and South Africa routes. They involved issues that appear to be analogous in some respects to the situation on the trans-Tasman. It might therefore be expected that the IASC would apply similar analysis to the Tasman as it did in those earlier cases. Those earlier applications raised competition concerns for the IASC because they applied to substantial routes and involved code sharing between the main competitors on the routes. In both situations there was only limited third-country carrier competition and new carrier entry was unlikely.

An example of the Commission's considerations can be seen in Decision [2002] IASC 218, where code sharing by Japan Airlines on Qantas' services between Melbourne and Tokyo was authorised, subject to conditions including limiting duration and the number of seats involved. The IASC noted that code sharing on the major Sydney-Tokyo sector was not envisaged by the carriers. It noted that this was a major route on which Qantas and Japan Airlines are established direct competitors and it was difficult to foresee circumstances where code sharing on this route would be anything but anti-competitive with little public benefit. This application, and other similar ones, was approved after the Commission found there were sufficient public benefits associated with the proposals to offset the negative impact on competition.

On the face of it, based on the evidence from these earlier cases, it seems likely that code sharing on Australia – New Zealand city pairs by the dominant market operators, particularly the larger city pairs, would raise competition concerns for the IASC. The Commission has pointed out though, in allowing code sharing by several third country airlines with Qantas on the Tasman in past cases, that the open capacity regime provides scope for new entry. However, those cases involved code sharing on a relatively small scale and the anti-competitive impact of those activities is likely to be limited compared with code sharing by Qantas and Air New Zealand. However, it would be a matter for the applicant to present argument on this point, and to demonstrate other public benefits that may arise against the relevant decision criteria. Further, as I have noted above, all applications to the IASC must be considered on their merits. In other words, the IASC's conclusions in earlier cases, including where ACCC authorisations have been involved, should not be taken to imply any particular outcome on future applications from Qantas to code share with Air New Zealand on JAO routes, or on non-JAO routes should this be sought.

Yours sincerely

Michael Bird
Executive Director

6 February 2003