



Australian Government

International Air Services Commission

DECISION

Decision: [2010] IASC 210
Variation of: [2006] IASC 117, [2006] IASC 124 and [2008] IASC 127
The route: Japan
The applicant: Qantas Airways Limited
(ACN 009 661 901) (Qantas)
Public Register: IASC/APP/201023

1 The application

1.1 Qantas applied to the Commission on 19 October 2010 for a variation of three determinations to enable the continuation and expansion of code sharing by Japan Airlines on various Jetstar services between Australia and Japan for a further two year period from 1 January 2011. The current period of authorisation ends on 31 December 2010.

1.2 There are three aspects to the application. First, Japan Airlines would continue to code share on Jetstar's services between Cairns and Tokyo. Secondly, code sharing would also continue on Jetstar's Gold Coast – Osaka services but would no longer involve Sydney - Gold Coast. Finally, Qantas sought a further variation to the determinations to enable Japan Airlines to code share on Jetstar's Cairns – Osaka and Gold Coast – Tokyo services.

1.3 Qantas advised that the proposed code share would be governed by amendments to the 2007 free sale code share agreement between Jetstar and Japan Airlines. A more detailed summary of the application is set out below.

1.4 The Commission published a notice on 19 October 2010 inviting submissions about the application. A submission was received on 2 November 2010 from the Queensland Government in support of the Qantas application. Public material supplied by the applicant and submissions are filed on the Register of Public Documents. Confidential data supplied by Qantas as a condition of approval of the code share arrangements is filed on the Commission's Confidential Register.

2 Traffic Levels

2.1 The table below summarises traffic levels on the Japan route for the year ending August 2010, compared with the previous year. It shows that total traffic rose by over eight percent, year on year. However, there continue to be markedly different trends in traffic growth between the Australian resident and Japanese visitor segments of the market. The resident market has risen strongly over the past year, after remaining relatively flat through the previous year, when international travel was weak as a result of the global financial crisis.

2.2 The larger Japanese visitor component has finally shown some return to growth over the past year, with most of that growth coming during the three months from June to August 2010. Prior to this, the Japanese visitor market had been falling dramatically for a number of years. The size of the visitor market now, at just over 800,000, is about half what it was in 1997, when there were over 1.6 million visitor arrivals and departures. The sharpest falls have occurred since 2004.

2.3 The continuation of the trends over the past decade or more has seen a change to the point where a route which was once overwhelmingly dominated by Japanese travellers now has a substantial proportion of Australian residents.

AUSTRALIA - JAPAN						
MONTHLY OD TRAFFIC SUMMARY						
	LATEST YEAR ENDING DATA	AUG 2009 PAX	AUG 2010 PAX	PAX EWEW or OW		% CHG
TOTAL OD TRAFFIC		1,048,665	1,134,688	10,910 EWEW		8.2%
TOTAL VISITORS (ARR & DEP)		754,767	801,189	7,704 EWEW		6.2%
(Proportion of Total OD Traffic)		(72.0%)	(70.6%)			
TOTAL RESIDENTS (ARR & DEP)		293,897	333,501	3,207 EWEW		13.5%
(Proportion of Total OD Traffic)		(28.0%)	(29.4%)			
TOTAL ARRIVALS (VIS & RES)		522,659	571,057	10,982 OW		9.3%
TOTAL DEPARTURES (VIS & RES)		526,006	563,631	10,839 OW		7.2%
TOTAL VISITOR ARRIVALS		376,431	401,275	7,717 OW		6.6%
TOTAL RESIDENT DEPARTURES		147,669	163,719	3,148 OW		10.9%
SHORT TERM VISITOR ARRIVALS		368,231	393,890	7,575 OW		7.0%
SHORT TERM RESIDENT DEPARTURES		144,522	160,461	3,086 OW		11.0%

Source: Australian Bureau of Statistics

3 Provisions of the relevant air services arrangements

3.1 The air services arrangements between Australia and Japan allow code sharing between the designated airlines of Australia and Japan. Under these arrangements, where the designated airlines code share with each other, capacity is counted as being exercised only by the operating carrier. As Jetstar is the operating carrier, the Commission's approval is required for Japan Airlines to code share on Jetstar's flights.

4 Detailed summary of application

4.1 Qantas summarised the history of the code share arrangements, noting they have been in place since 2007. They originally covered Sydney-Osaka-Brisbane-Sydney

services, with Gold Coast later replacing Brisbane, then Cairns-Tokyo being added. The arrangements were most recently authorised by the IASC in late 2008.

4.2 Qantas summarised developments in the Australia – Japan market. It said that conditions had deteriorated since the Commission’s 2008 review. Qantas stated that total passenger numbers and Japanese visitors had declined for a fifth consecutive year. Weakness in the Japanese inbound market was of concern because this market was important for the Qantas Group and Australian tourism. Australian resident numbers partially offset weakness in the visitor market but residents made up only 31% of the market in the year ending June 2010.

4.3 The weak Japanese economy, increased destination competition, exchange rate movements and the effects of the global financial crisis have all contributed to the weakness in visitor numbers to Australia. The Japanese economy contracted in 2009 and only moderate growth is forecast in 2010. The strength of the yen against the US dollar and Chinese and Korean currencies has contributed to stronger Japanese visitation to these destinations. Although the yen has strengthened relative to the Australian dollar, this has not translated to increased visitor numbers. The H1N1 influenza outbreak also dampened demand, with Jetstar cancelling about a third of its services to Japan in mid-2009. Qantas cited the Tourism Forecasting Council’s forecast that visitor arrivals from Japan are expected to remain around 2009 levels for the next ten years.

4.4 Qantas summarised the recent history of changes to the Group’s operations over the past two years or so. It rationalised operations in 2008. Qantas suspended its Melbourne – Tokyo services and reduced frequencies from nine to seven per week on the Sydney – Tokyo sector. Jetstar suspended Cairns – Osaka – Nagoya services and took over from Qantas on the Cairns – Tokyo sector.

4.5 Subsequently, Qantas has maintained its Sydney – Tokyo and Perth – Tokyo services, while Jetstar resumed four weekly Cairns – Osaka services in April 2010 and has increased its Gold Coast – Tokyo and Cairns – Tokyo services from five to seven flights per week. Japan Airlines has suspended its Tokyo – Brisbane services as part of a range of international and domestic service cutbacks aimed at returning the carrier to profitability. JALways continues to operate daily between Tokyo and Sydney.

4.6 Qantas argued that it faced a competitive landscape from other destinations with a growing presence of low cost carriers. Since the Commission’s previous review, the number of low cost airlines serving Japan has more than doubled to six. It cited expansion plans by Air Asia X and All Nippon in the low cost area. The Japanese Government was demonstrating support for such carriers.

4.7 In terms of route performance, Qantas said that it had been sustaining losses prior to the 2008 rationalisation. The commercial situation had improved overall, although Jetstar’s yields remained subdued.

4.8 Qantas concluded that the code share arrangements would enable Jetstar to continue having access to Japan Airlines’ distribution capability. This included its wholesale and retail presence in the Japanese market. This, together with marketing of

Jetstar's services by both airlines, would stimulate more inbound tourism from Japan than Jetstar would achieve alone.

5 Summary of submission received

5.1 The Aviation Steering Committee of the Queensland Government expressed its support for the continuation and extension of the code share arrangements between Jetstar and Japan Airlines. The committee said that Japan was a significant market for inbound tourism to Queensland and the Gold Coast and Tropical North Queensland regions in particular. It cited Tourism Research Australia's findings that there were over 210,000 Japanese visitors to Queensland in the year ending 30 June 2010, representing 62% of the total market to Australia. These visitors spent an estimated \$354 million in Queensland.

5.2 The withdrawal by Japan Airlines from the Brisbane – Narita sector had reduced capacity to Queensland by 20%. The loss of Japan Airlines' extensive distribution and marketing was limiting the ability to market Queensland effectively to the Japanese tourism industry. Authorisation of the code share would allow Queensland tourism to continue to be assisted by Japan Airlines' extensive distribution network.

5.3 Jetstar's services were vital to the Queensland tourism industry. Extending the code share with Japan Airlines was seen as essential to sustaining Japanese visitor numbers, especially after the withdrawal of Japan Airlines from Brisbane.

6 Commission's consideration

6.1 When considering applications to vary determinations, the Commission must decide whether the determinations, as varied, would be of benefit to the public. Under section 6.3 of the Minister's policy statement, where a carrier requests a variation of a determination to allow it flexibility in operating its capacity and no submission is received about the application, only the criteria in paragraph 4 of the policy statement are applicable. Under paragraph 4, the use of entitlements by an Australian carrier that is reasonably capable of obtaining the necessary approvals and of implementing its proposals is of benefit to the public. Qantas is an established carrier which clearly meets the paragraph 4 criteria in this case.

6.2 Under Section 15(2)(e) of the Act, the Commission must include a condition in determinations stating the extent to which the carrier may use that capacity in joint services with another carrier. The Minister's policy statement indicates that the Commission would generally be expected to authorise code sharing but where it has serious competition concerns about a particular proposal is able to subject it to detailed consideration against the public benefit criteria contained in paragraph 5 of the policy statement.

6.3 The Commission has for a number of years subjected to careful scrutiny Qantas' applications for code sharing with Japan Airlines on the Japan route. This is because of concerns about the potential impact of such arrangements on competition in this large market. However, the continued weakness in demand on the Japanese route has meant

that the Commission has not seen sufficient concern with the proposed code sharing arrangements to subject them to the paragraph 5 criteria. The weakness in demand has led to extensive restructuring of services on the Japan route over recent years, with Japan Airlines and Qantas both ending services on a number of sectors. Jetstar has taken over flying on a number of sectors. The Commission authorised code sharing between Japan Airlines and Jetstar in 2007 on Sydney/Brisbane – Osaka services. It authorised the substitution of the Gold Coast for Brisbane in 2008.

6.4 The most recent reviews were conducted in June and September 2008. In those reviews the Commission had regard to the ongoing weakness in Japanese visitor demand for travel to Australia, which was only partially offset by increasing numbers of Australian residents flying to Japan. The reviews also took account of Qantas' withdrawal of its Tokyo – Melbourne services in September 2008 and Cairns – Tokyo services in December 2008, with Jetstar taking over flying on the Cairns – Tokyo sector. In the September 2008 review, the Commission authorised code sharing between Jetstar and Japan Airlines on the Cairns–Tokyo sector, as replacement for the code share arrangement between Qantas and Japan Airlines. This approval, as with Sydney/Gold Coast - Osaka, extends to 31 December 2010.

6.5 More recently, Japan Airlines has withdrawn its Brisbane – Tokyo services. The result of the various changes over time is that the scope of code sharing between Qantas Group carriers and Japan Airlines has contracted. The only code sharing now authorised by the Commission is by Japan Airlines on Jetstar's services between Sydney/Gold Coast and Osaka, and between Cairns and Tokyo. Under the current proposal, Sydney would be dropped from the arrangements. Two new sectors would be subject to code sharing, namely Cairns - Osaka and Gold Coast – Tokyo.

6.6 Traffic levels on the Japan route have been volatile since the Commission's 2008 reviews but the trend has continued the downwards trend of the past six years or so. That trend has correlated with a generally rising Australian dollar, making travel to Australia more expensive, and a weak Japanese economy which has seen reduced numbers of Japanese travelling overseas.

6.7 There were very large month on month declines in visitor traffic through the later months of 2008 and throughout 2009. This period coincided with the working through of the effects of the global financial crisis and a weak Japanese economy. The situation stabilised through the first five months of 2010 and strong growth was evident in June, July and August 2010. The Australian dollar is now weaker than for some years prior to late 2008 and there are signs of recovery in the Japanese economy. However, despite these gains, visitor numbers for those months in mid-2010 were still slightly below 2008 levels. Nevertheless, this is the first sign of recovery in the Japanese visitor market for quite some years. Australian resident travel has continued to grow steadily and now makes up a substantial proportion of the overall market where once it was a very minor part.

6.8 Although there are recent signs of recovery in the market as a whole, the market has contracted since the time of the previous review, continuing a long period of decline. In the continuing weak market circumstances, the Commission sees no grounds on which

to subject the current application to the paragraph 5 criteria in the Minister's policy statement.

6.9 In relation to pricing, the Commission has reviewed the latest confidential passenger revenue yield data reported to it by Qantas for Qantas' Group operations on the Cairns–Tokyo and Gold Coast – Osaka services. Yields on the sector have clearly increased since the 2008 review, but not to an extent which raises concerns for the Commission while the market remains relatively subdued. The route was loss making for Qantas at the time of the previous review, leading to the major service restructuring on the route with ending of Melbourne services and Qantas' withdrawal from Cairns, overall reduced capacity, and Jetstar taking over much of the flying. Recently improved yields and the lower cost base of Jetstar relative to Qantas would suggest the profitability situation has improved.

6.10 As noted at the 2008 review, the free-sale code share arrangements, which replaced the earlier more competitive block space arrangements, do maintain Japan Airlines' presence in the Cairns – Tokyo and Gold Coast - Osaka sectors. The Commission sees no reason to alter its view from the earlier review that Japan Airlines would be unlikely to enter these sectors in its own right. This view is reinforced by the recent withdrawal of Japan Airlines from the Brisbane – Tokyo sector as part of an extensive program of international service reductions by that airline.

6.11 The Commission is satisfied that there would be no lessening of public benefits by allowing code sharing to continue on these two sectors. As the Commission noted at its previous review, Jetstar's ability to establish and maintain itself in the Tokyo market will be enhanced by the assistance of Japan Airlines in the marketing of the new services and of Cairns as a destination. There is little prospect of anti-competitive behaviour arising from the arrangement in these circumstances. This view was reinforced by the Queensland Government in its submission. For the same reasons, the Commission will extend code sharing authorisation to the two new sectors sought by Qantas; namely Cairns – Osaka and Gold Coast – Tokyo.

6.12 The Commission will authorise the arrangements until 31 December 2012. As noted above, there are some early signs of recovery in the number of Japanese visitor arrivals to Australia. However, as Qantas noted in its application, the forecast for future years is subdued. Nevertheless, if demand pressures build unexpectedly on the Japan route, there continues to be potential for the emergence of adverse impacts of the arrangements on competition. However, a positive aspect to the past weakness in the Japan market is that there is now scope for a new Australian entrant. There is substantial capacity now available for allocation as a result of the return of capacity by Qantas over recent years. At one time, virtually all of the Australian capacity entitlements were allocated to Qantas. The potential threat of entry by another Australian carrier might impose some further degree of pricing discipline upon the Qantas Group.

6.13 The Commission will maintain its usual conditions requiring Qantas to report six-monthly on traffic carried by Japan Airlines on Jetstar's services and Jetstar's revenue yields for the code share sectors.

7 Decision [2010] IASC 210

7.1 In accordance with section 24 of the Act, the Commission varies Determinations [2006] IASC 117, [2006] IASC 124 and [2008] IASC 127, as requested by Qantas, by :

For Determination [2006] IASC 117

adding the following conditions

- “Jetstar may use the capacity to provide services jointly with Japan Airlines until 31 December 2012 in accordance with:
 - the code share agreement of 9 February 2007, as amended, with such additional conditions (if any) as the Commission may require prior to code share services commencing, or as varied except in relation to:
 - Cairns–Tokyo, Gold Coast–Osaka, Cairns–Osaka and Gold Coast–Tokyo being the city pairs served; or
 - any financial adjustment; or
- Jetstar must submit, prior to the next Commission review of the code share arrangements, a report on the number of code share seats sold by Japan Airlines on Jetstar–operated services between Cairns–Tokyo, Gold Coast–Osaka, Cairns–Osaka and Gold Coast–Tokyo and Jetstar’s yields per revenue passenger kilometre for all passenger classes on these services”

deleting the following conditions

- “Jetstar may use the capacity to provide services jointly with Japan Airlines until 31 December 2010 in accordance with:
 - the code share agreement of 9 February 2007, as amended, with such additional conditions (if any) as the Commission may require prior to code share services commencing, or as varied except in relation to:
 - Cairns–Tokyo being the city pair served; or
 - any financial adjustment; or
- Jetstar must submit to the Commission reports six-monthly on the number of code share seats sold by Japan Airlines on Jetstar–operated services between Cairns–Tokyo; and Jetstar’s yields per revenue passenger kilometre for all passenger classes on these services”

For Determination [2006] IASC 124

adding the following conditions

- “Jetstar may use the capacity to provide services jointly with Japan Airlines until 31 December 2012 in accordance with:

- the code share agreement of 9 February 2007, as amended, with such additional conditions (if any) as the Commission may require prior to code share services commencing, or as varied except in relation to:
 - Cairns–Tokyo, Gold Coast–Osaka, Cairns–Osaka and Gold Coast–Tokyo being the city pairs served; or
 - any financial adjustment; or
- Jetstar must submit, prior to the next Commission review of the code share arrangements, a report on the number of code share seats sold by Japan Airlines on Jetstar–operated services between Cairns–Tokyo, Gold Coast–Osaka, Cairns–Osaka and Gold Coast–Tokyo and Jetstar’s yields per revenue passenger kilometre for all passenger classes on these services”

deleting the following conditions

- “Jetstar may use the capacity to provide services jointly with Japan Airlines until 31 December 2010 in accordance with:
 - the code share agreement of 9 February 2007, as amended, with such additional conditions (if any) as the Commission may require prior to code share services commencing, or as varied except in relation to:
 - Sydney/Gold Coast – Osaka being the city pair served; or
 - any financial adjustment; or
- Jetstar must submit to the Commission reports six-monthly on the number of code share seats sold by Japan Airlines on Jetstar–operated services between Sydney/Gold Coast–Osaka; and Jetstar’s yields per revenue passenger kilometre for all passenger classes on these services”

For Determination [2008] IASC 127

adding the following conditions

- “Jetstar may use the capacity to provide services jointly with Japan Airlines until 31 December 2012 in accordance with:
 - the code share agreement of 9 February 2007, as amended, with such additional conditions (if any) as the Commission may require prior to code share services commencing, or as varied except in relation to:

- Cairns–Tokyo, Gold Coast–Osaka, Cairns–Osaka and Gold Coast–Tokyo being the city pairs served; or
- any financial adjustment; or
- Jetstar must submit, prior to the next Commission review of the code share arrangements, a report on the number of code share seats sold by Japan Airlines on Jetstar–operated services between Cairns–Tokyo, Gold Coast–Osaka, Cairns–Osaka and Gold Coast–Tokyo and Jetstar’s yields per revenue passenger kilometre for all passenger classes on these services”

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 - Sydney/Gold Coast – Osaka being the city pair served; or
 - any financial adjustment; or
- Jetstar must submit to the Commission reports six-monthly on the number of code share seats sold by Japan Airlines on Jetstar–operated services between Sydney/Gold Coast–Osaka; and Jetstar’s yields per revenue passenger kilometre for all passenger classes on these services”

Dated: 11 November 2010

Stephen Bartos
Member Presiding

Ian Smith
Member