DECISION

DECISION NO: [2002] IASC 219
VARIATION OF: DETERMINATION [2002] IASC 115
THE ROUTE: PAPUA NEW GUINEA
THE APPLICANT: QANTAS AIRWAYS LIMITED (ACN 009 661 901) (QANTAS)
PUBLIC REGISTER FILE: IASC/APP/200214

1 The application for variation

1.1 On 9 July 2002, Qantas applied to the Commission to vary Determination [2002] IASC 115, which allocates 1550 seats per week on the Australia – Papua New Guinea (PNG) and authorises Qantas to use the capacity to provide joint services with Air Niugini. Qantas sought a reduction in its capacity allocation to 1,000 seats per week and approval to expand its commercial arrangement to allow it to code share on all of Air Niugini's services between Australia and Port Moresby from 1 September 2002.

1.2 The Commission published a notice on 12 July 2002 inviting submissions about the application. No submissions were received.

1.3 All non-confidential material supplied by the applicant is filed on the Register of Public Documents. Confidential material supplied by the applicant is filed on the Commission's confidential register.

2 Provisions of relevant air services arrangements

2.1 Operation of the capacity as proposed in the application is consistent with the provisions of the Australia-PNG air services arrangements. Capacity exercised by the marketing carrier on the services of the operating carrier counts as capacity under the air service arrangements.

3 Applicant's proposal

3.1 Qantas sought a reduction in its allocated capacity and authorisation to extend its commercial arrangement with Air Niugini to enable code sharing by Qantas on all of Air Niugini's operated services between Australia and Port Moresby. Currently the code share covers only Cairns – Port Moresby services.

3.2 Under the proposal, Qantas would cease to operate its four B767-300 services per week on a Sydney-Brisbane-Port Moresby and vv routing. Air Niugini would increase its total level of services to 18 per week from the current 15 per week. The additional three services would operate on the Brisbane – Port Moresby sector. Air Niugini would substitute a leased B767-300 aircraft for its existing A310-300 aircraft to fly the Sydney/Brisbane – Port Moresby and Brisbane – Port Moresby sectors. The weekly services to be operated, relative to the current arrangements are:

- Sydney - Brisbane - Port Moresby: Two B767-300 (cf. six services in total now, four B767-300 by Qantas and two A310-300 by Air Niugini)
- Brisbane – Port Moresby: Four B767-300 (cf. one A310-300 now)
- Cairns – Port Moresby: 12 F28-4000 (cf. 11 F28-4000 and one A310-300 now)

3.3 Under the proposal, Qantas would code share on a "hard block" basis on each Air Niugini B767-300 service. The block involves the purchase of 12 business class and 70 economy seats on each Air Niugini flight. Qantas would have an option to purchase up to a further four business and 30 economy seats (a "soft block"). Qantas would also purchase cargo space on each service on a similar basis.

3.4 Qantas would maintain the existing code share arrangement on Air Niugini's F28 flights between Cairns and Port Moresby and extend it to cover a twelfth weekly service being introduced by Air Niugini as part of the revised arrangement between the two carriers.

3.5 Qantas states that Air Niugini's financial situation has now become critical. Following a meeting between the Prime Ministers of Australia and PNG, Qantas was invited to consider possible arrangements with Air Niugini to enhance its viability, while being compatible with Qantas' own commercial objectives. Qantas attached to its application a press release by the Prime Minister of PNG announcing the approval of a Government Guarantee for Air Niugini to enable it to proceed with a code-share arrangement with Qantas. The Prime Minister stated that 'the codeshare arrangement is necessary for the financial future of our airline' and that 'the go-ahead for the codeshare would coincide with a significant restructuring of Air Niugini management and its finances prior to privatisation.' Qantas says that the Prime Minister of PNG has written to the Australian Prime Minister to underscore the importance of the arrangements for the restructuring of Air Niugini.

3.6 As part of the new commercial agreement, Air Niugini would be required to meet Qantas' specifications concerning safety and security, maintenance, aircraft interiors, passenger service standards and so on.

3.7 The proposed arrangement is for a duration of five years, which would give Air Niugini the certainty necessary to proceed with the lease of the B767-300 aircraft.

3.8 Qantas identified a range of benefits associated with the proposal. Qantas states that without the commercial agreement, Air Niugini would be forced to withdraw from the route. The continuation of services is vital to maintaining commercial and social links and the overall bilateral relationship between Australia and PNG. In the absence of the commercial agreement, it is likely that Air Niugini would have to shut down its entire international network, with adverse impacts on its domestic operations.

3.9 Qantas claimed that price competition on services between Sydney/Brisbane and Port Moresby would continue under the code share, noting that Qantas would be required to pay for its fixed seat block, which constitutes over 35% of capacity on the aircraft.

3.10 Flight timings for the services would reflect the pattern of demand on the route and operational requirements of the aircraft. Qantas would provide interline connections to Sydney for the terminating Brisbane services.

3.11 The code share arrangements would see an improvement in average services levels on the route, with a number of product improvements planned. Qantas customers will also accrue frequent flyer points, as Air Niugini is a member of Qantas' loyalty program.

3.12 Qantas says that the code share will enable a higher level of frequency to be operated between Sydney/Brisbane and Port Moresby than if Qantas was left to service these sectors on its own. In relation to Cairns – Port Moresby, Qantas states it would not be in a position to serve this sector should Air Niugini cease services. Passengers on this sector comprise about 35% of total traffic on the Australia – PNG route. The commercial agreement would secure the ongoing retention of the Cairns services.

3.13 Qantas will benefit financially from the introduction of the B767-300 aircraft by Air Niugini. Qantas will provide assistance, on a fee for service basis, with technical and specification reviews for sourcing the aircraft, in training, and establishing maintenance systems.

3.14 Qantas says it remains committed to the PNG route, evidenced by the safeguards it has incorporated into the commercial agreement to ensure effective servicing of the route. Qantas considers that the proposal offers a sustainable level of competitive, high quality operations and will assist the long term viability of Air Niugini.

4 Commission's consideration

4.1 Qantas' Determination [2002] IASC 115 authorises code sharing with Air Niugini in accordance with the code share agreement dated 23 October 1987, or any subsequent code share agreement between Qantas with Air Niugini for operations on the Australia-Papua New Guinea route with the prior approval of the Commission. In view of this authorisation, the Commission could facilitate the new code share arrangement by resolution. However, the Commission will look more closely at the new arrangements in this case.

4.2 At first glance, the proposed arrangement between Qantas and Air Niugini appears likely to operate to the detriment of public benefit in certain ways. The new arrangement involves a significant expansion in the scope of the code share arrangements in conjunction with Qantas ceasing to provide services in its own right.

4.3 The already limited degree of competitive pressure on air fares on this route is likely to be lessened further under the new arrangements which would cover all sectors on the route, rather than just Cairns – Port Moresby as now. There are no third-country carriers operating on the route, which might otherwise place competitive pressure on Qantas and Air Niugini. The hard block code share arrangement does provide at least some incentive for competitive pricing by the two partners, but the absence of any third country competition places them under little pressure. Neither party is likely to price aggressively.

4.4 In terms of service choice and frequency, Sydney and Brisbane passengers will join Cairns travellers in having no choice of carrier or schedules. This is a poor outcome. Further, passengers originating in or destined for Sydney would have only two services per week, compared with six at present.

4.5 Nevertheless, there are some public benefit improvements. Brisbane and Cairns passengers would have an additional weekly service available. In-flight services standards should rise with the introduction of the B767-300 aircraft. This would benefit all Sydney and Brisbane travellers.

4.6 More importantly, the arrangement should ensure the continuation of Air Niugini services. The loss of Air Niugini from the route would be likely to lead to a far greater loss of public benefit than under the new arrangements. Cairns services may be lost altogether and the extent of participation by Qantas on the Sydney/Brisbane sector in its own right could not be gauged with any certainty. There would be likely to be strongly negative flow on consequences for tourism and other aviation related industries.

4.7 The clear and real risk of the loss of a principal operator from the PNG route, leaving sharply reduced levels of service and associated public benefit, leads the Commission to the conclusion that it should authorise the new arrangements.

4.8 The Commission notes that Qantas has sought a variation to retain 1,000 seats per week, down from its current allocation of 1,550. Qantas requires only a little over 800 seats per week to facilitate the level of code sharing under the commercial agreement, but has sought to retain the additional seats to give it flexibility. The Commission notes that there are already 1,230 seats of capacity remaining available for allocation, increasing to 1,780 per week with Qantas returning 550 seats to the shelf under its proposal. The Commission therefore has no objection to Qantas retaining some seats in addition to those it would use under the code share arrangement, in order to meet unanticipated demand increases.

5 Decision ([2002] IASC 219)

5.1 In accordance with section 24 of the Act, the Commission varies the allocation of capacity on the Papua New Guinea route by Determination [2002] IASC 115 from 1,550 seats to 1,000 seats per week in each direction. The conditions of the determination are amended by:

replacing:

- "the capacity may be used by Qantas to provide services jointly with Air Niugini in accordance with:
  - the code share agreement dated 23 October 1987;

- or any subsequent code share agreement between Qantas with Air Niugini for operations on the Australia-Papua New Guinea route with the prior approval of the Commission; and”

with:

- “the capacity may be used by Qantas to provide services jointly with Air Niugini in accordance with:

  - the code share agreement dated 23 October 1987;

  - the finalised code share agreement relating to services between Sydney/Brisbane/Port Moresby and between Brisbane and Port Moresby being approved by the Commission prior to the commencement of services;

  - or any subsequent code share agreement between Qantas with Air Niugini for operations on the Australia-Papua New Guinea route with the prior approval of the Commission; and”

Dated: 8 August 2002

Ross Jones Chairman	Michael Lawriwsky Member	Stephen Lonergan Member