



## Australian Government

### International Air Services Commission

#### DETERMINATIONS

**Determinations:** [2007] IASC 120 and [2007] IASC 121  
**The Route:** Solomon Islands  
**The Applicants:** Pacific Blue Australia Airlines (Aust) Pty Ltd  
(ACN 097 892 389) (Pacific Blue Australia) and Sky Air  
World Pty Ltd (ACN 121 705 646) (Sky Air World)

**Public Register File:** IASC/APP/200718

#### 1 The applications

1.1 On 27 September 2007, Pacific Blue Australia applied for an allocation of 540 seats per week in each direction on the Solomon Islands route. A supplementary application for a further 180 seats per week was made on 19 October 2007, bringing the total sought to 720 seats per week. Pacific Blue Australia planned to commence services in the latter part of 2007 with twice weekly flights between Brisbane and Honiara using a wet-leased B737-300 aircraft with a capacity of 138 seats. The airline intended to upgrade the service over time to be operated with Pacific Blue's own B737-800 aircraft with 180 seats. The capacity was planned to be fully utilised by November 2008, when four services per week would be operated with Pacific Blue Australia B737-800 aircraft.

1.2 In response to Pacific Blue Australia's initial application, the Commission published a notice on 2 October 2007 inviting other applications for all or any part of the capacity sought by Pacific Blue Australia on the Solomon Islands route. A notice of intention to make an application for capacity on the route was received from Sky Air World on 5 October 2007. As the Commission anticipated that the combined amount of capacity sought by the two carriers would exceed the capacity available for allocation, this created a contested situation. Accordingly, the Commission wrote to Sky Air World on 11 October 2007 inviting it to address the additional public benefit criteria in paragraph 5 of the Minister's policy statement in the context of its application, or separately to its application by 19 October 2007. The Commission also wrote on 11 October 2007 to Pacific Blue Australia, inviting it to address the paragraph 5 criteria.

1.3 On 16 October 2007, Sky Air World applied for 658 seats of capacity per week in each direction on the Solomon Islands route. Sky Air World planned to use the capacity to operate daily return services between Brisbane and Honiara, initially with Embraer E170 aircraft with a seating capacity of 76 seats. Services are planned to commence by late January 2008 or possibly earlier. Sky Air World expects to take delivery in March 2008 of an Embraer E190 aircraft with 94 seats capacity and to introduce this to the Solomon Islands route from that time, replacing the smaller E170. The capacity sought is then expected to be fully utilised.

1.4 The Commission published a notice on 17 October 2007 inviting submissions from interested parties about the applications. A submission was received from the Brisbane Airport Corporation and this is summarised below. The Commission also wrote on 17 October 2007 to the then Department of Transport and Regional Services (DOTARS) inviting its views on whether it considered Sky Air World to be reasonably capable of obtaining the approvals necessary to operate services on the Solomon Islands route. DOTARS responded by letter on 6 November 2007.

1.5 On 19 October 2007, both Pacific Blue Australia and Sky Air World wrote in support of their respective applications, addressing the paragraph 5 criteria, in response to the Commission's invitation. As noted above, at this time Pacific Blue Australia also advised that it was seeking an additional 180 seats of capacity per week, bringing the total sought to 720 seats per week. The extra capacity was proposed to be used to provide an additional (fourth) weekly flight. The Commission published a notice on 24 October 2007 inviting other applications for the 180 seats of capacity per week or submissions about the application. No applications or submissions were received.

1.6 Both applicants made presentations to the Commission on 16 November 2007, in support of their proposals.

1.7 Public material supplied by the applicants is filed on the Commission's Register of Public Documents. Commercial-in-confidence material from Sky Air World is filed on the Commission's Confidential Register.

## **2 Current services**

2.1 The Solomon Islands route is served by Solomon Airlines, the designated airline of the Solomon Islands. This airline operates four return services per week between Brisbane and Honiara using wet-leased B737 aircraft. Solomon Airlines also code shares on once weekly B737 services operated by Air Vanuatu between Sydney and Honiara via Vanuatu. Our Airline (formerly Air Nauru), the designated airline of Nauru, operates twice weekly B737-300 services on this sector.

2.2 No Australian carrier operates scheduled passenger services on the route. The Australian freight airline, HeavyLift Cargo Airlines (HeavyLift) operates B727 or Shorts Belfast cargo services between Cairns and Honiara (once per week) and between Brisbane and Honiara (also once per week).

## **3 Provisions of relevant air services arrangements**

3.1 There are 850 seats per week of passenger capacity in each direction on the Solomon Islands route available for allocation to Australian designated airlines. The air services arrangements between Australia and the Solomon Islands permit multiple airline designation.

## **4 Summary of passenger traffic on Solomon Islands route**

4.1 A summary of the traffic carried by air between Australia and the Solomon Islands, both on direct services and on flights via intermediate points, is set out in the following table.

Australia – Solomon Islands passenger traffic 2004 - 2007

Traffic category	Year ended July				Compound annual growth rate 04-07
	2004	2005	2006	2007	
Direct traffic (Annual % change)	18,000	21,900 (+21.7%)	25,000 (+14.2%)	27,000 (+8.0%)	(73.6%) 14.5%
Indirect traffic (Annual % change)	3,500	3,400 (-2.9%)	3,600 (+5.9%)	3,700 (+2.8%)	(10.1%) 1.9%
Beyond traffic (Annual % change)	3,800	4,800 (+26.3%)	5,100 (+6.3%)	5,900 (+15.7%)	(16.1%) 15.8%
Total traffic (Annual % change)	25,300	30,100 (+19.0%)	33,700 (+12.0%)	36,700 (+8.9%)	(100.0%) 13.2%

Source: Australian Bureau of Statistics

4.2 The table shows that there has been solid growth in traffic on the route, with average annual growth of over 13% in total traffic, which includes passengers travelling directly or indirectly between Australia and the Solomon Islands, or to points beyond. Direct traffic, which makes up nearly 74% of the market has grown at over 14% per annum.

4.3 Although the growth rate has been significant, it has been from a small base, so that the market is still comparatively small. For origin - destination travellers flying directly between the two countries, in practice Brisbane – Honiara, an average of 260 passengers each way each week were carried in the year ending July 2007. Including passengers travelling via intermediate points, the average was 295 passengers each way each week. Australian resident travellers make up about 57% of the origin-destination market, compared with 43% for visitors to Australia from the Solomon Islands.

4.4 The total origin – destination market for the year ending August 2007 of about 31,000 passengers per annum is larger than the Cook Islands (21,000) and Tonga markets (26,000), but considerably smaller than other neighbours Samoa (50,000) and Vanuatu (106,000). The Fiji market is an order of magnitude larger than the Solomon Islands market with 449,000 passengers in the August 2007 year.

## **5 Summary of applicants' claims**

5.1 The applicants' claims against the paragraph 4 and paragraph 5 criteria in the Minister's policy statement are summarised as follows.

### **Paragraph 4 criteria**

#### **Pacific Blue**

5.2 Pacific Blue Australia advised that it operated successfully international services on the trans-Tasman route and to a number of Pacific island destinations. The proposed services would be flown initially with wet-leased B737-300 aircraft, later to be replaced with Pacific Blue Australia B737-800 aircraft. In its supplementary application of 19 October, Pacific Blue Australia indicated that it had received strong support from its stakeholders for the Honiara services. This, together with Pacific Blue Australia's assessment of the market's potential, had led it to consider that additional services could be mounted sooner rather than later.

#### **Sky Air World**

5.3 Sky Air World was registered as a proprietary limited company with the Australian Securities and Investment Commission in late 2006. In May 2007, it was granted an Air Operator's Certificate by the Civil Aviation Safety Authority (CASA) for international regular public transport services. Currently Sky Air World operates a leased Embraer E170 aircraft. The company employs forty-three staff in Brisbane and expects to double this number during 2008 with the planned arrival of four new aircraft, including two Embraer E190 aircraft (94 seats capacity), the first of which is to be delivered in March 2008.

5.4 Sky Air World is a prospective Australian international airline which has not previously been designated by Australia to provide regular scheduled international services. However, Sky Air World has some international flying experience. It operated services on the Solomon Islands route between May and August 2007 with its E170 aircraft. The services were flown by Sky Air World under a wet lease of its aircraft to Solomon Airlines. Other wet-lease services were provided for Solomon Airlines between the Solomon Islands and other destinations in the south-west Pacific.

5.5 More recently, Sky Air World received approval from the Department of Transport and Regional Services (DOTARS) to operate a series of international passenger charter flights in its own right between Brisbane and Honiara, although these services were not operated.

5.6 In addition to the services it previously operated on the Solomon Islands route, Sky Air World provides ad-hoc charter services for the Australian Defence Force and clients in the tourism and mining sectors.

5.7 Sky Air World is looking at options for short-term lease of aircraft to enable it to start operations earlier than January 2008.

5.8 Sky Air World considered that its team comprises individuals possessing a range of relevant skill requirements with extensive experience in domestic and international operations. An organisational chart was provided, together with detailed information about the qualifications and experience of key company personnel.

5.9 Sky Air World also provided confidential supporting information sought by the Commission from prospective new carriers, particularly concerning the company's financial status and projections for future operations.

## **Paragraph 5 criteria**

### Competition benefits

#### **Sky Air World**

5.10 Sky Air World argued that there was little commercial rationale for dividing the limited Australian capacity entitlements between two Australian carriers, noting that there are already foreign carriers operating on the route and there were less than 2,800 passenger movements per month during 2006-07. Sky Air World said that the route is not currently served adequately enough by the existing carriers in term of frequency or reliability, and suggested that Solomon Airlines financial difficulties were well documented.

5.11 Sky Air World referred to the proposed tariffs set out in its application. It suggested that these fares were sustainable even assuming conservative passenger loads. Sky Air World also said that it would offer higher frequency than Pacific Blue, while providing a similar level of available seat kilometres. The airline also indicated that it planned to offer a two-class service from early 2008, in contrast with currently available product offerings and those planned by Pacific Blue. Sky Air World noted that all services would be operated by Sky Air World's Embraer aircraft under its own Aircraft Operator's Certificate.

#### **Pacific Blue Australia**

5.12 Pacific Blue Australia advised that it has demonstrated its ability to operate successfully in thin seasonal markets by taking advantage of its low cost base and marketing and distribution capabilities. The airline plans to compete with the incumbent foreign carriers in all market segments and to offer an innovative product that differs from these competitors. Combined with its low fares, Pacific Blue Australia would stimulate the market and offer choice to consumers in both Australia and the Solomon Islands.

5.13 Pacific Blue Australia cited examples of the impact of its services on traffic growth rates in other markets in the region, specifically Brisbane – Vila and Brisbane - Nadi. It contrasted this with lower growth in the Sydney – Vila market, which it does not serve directly.

### Other Benefits

#### *Tourism Benefits*

#### **Sky Air World**

5.14 Sky Air World indicated that it planned to expand the market through low fare offerings and improved flight schedules, as well as through joint marketing campaigns with the Solomon Islands Visitors Bureau directed at promoting tourism and commerce within the Solomon Islands. The airline has budgeted \$2 million per annum for marketing.

5.15 Turning to the issue of route service possibilities beyond gateways, Sky Air World noted that its Brisbane services offered onward travel to Australian and international destinations, with Brisbane airport being served by twenty-nine other airlines. At the Solomon Islands end, Sky Air World pointed out that Honiara is the connection point for all of Solomon Airlines' domestic services. Sky Air World also indicated that it might look to develop services beyond Honiara to other parts of the region.

5.16 Sky Air World's schedules are designed to ensure good connections to other services, as well as providing convenient departure and arrival times.

### **Pacific Blue Australia**

5.17 Pacific Blue Australia referred to a range of capabilities which give it the ability to promote Australia to potential visitors – strong brand, network, sales, marketing and distribution. Pacific Blue Australia suggested that the potential for tourist traffic to Australia was less than the scope for developing travel from Australia to the Solomon Islands. However, Pacific Blue Australia noted that there had been growth of 20% and 29% in visitor arrivals from Fiji and Vanuatu respectively since the establishment of its services in September 2004.

#### *Consumer Benefits*

### **Sky Air World**

5.18 Sky Air World noted that Honiara and Brisbane were the only airport options for jet aircraft serving the route. It pointed out that it would offer six different fare types to consumers, all of which could be purchased using an internet booking engine or telephone reservations system. Sky Air World would also sell tickets in Honiara both through a sales counter at the airport and via a travel agent for over-the-counter sales within the city itself.

5.19 Sky Air World also pointed to the lower fares it proposed to offer compared with the incumbent carriers. These were detailed in its application. Sky Air World noted that Pacific Blue had yet to publicly disclose its fares.

5.20 Finally, Sky Air World said that it expected a reaction from incumbent carriers through more competitive fares and improved in-flight features so as to match the levels of comfort available on Sky Air World's modern equipment.

### **Pacific Blue Australia**

5.21 Pacific Blue Australia said that it would use a "whole of Australia" approach to marketing and selling travel to and from the Solomon Islands. This means that the airline would sell its services in all possible cities (most capitals plus Cairns and Townsville), using the connecting services of Virgin Blue for travellers behind the Brisbane gateway. Pacific Blue Australia cited statistics showing that over 50% of Australian resident

travellers to the Solomon Islands are travelling from non-Queensland cities. A smaller proportion of visitors from the Solomon Islands flew beyond Queensland to other Australian states. Pacific Blue Australia would also offer connecting services between Honiara and New Zealand cities.

5.22 Pacific Blue Australia also said that it would offer a range of fare products suitable to specific market segments, and that its fare levels would be significantly below those currently available.

#### *Trade benefits*

### **Sky Air World**

5.23 Sky Air World referred to the possibility of arrangements being made with the Solomon Islands Government to enhance an airport near to Honiara which could act as an alternate in the event of Honiara being closed for whatever reason. If this was achieved, the respective payloads for the E170 and E190 could be eight tonnes and eleven tonnes respectively as Sky Air World would need to carry less fuel than required to reach the current alternate. Assuming fifty passengers on a flight, this would make three and six tonnes of freight capacity available on the two Embraer aircraft types respectively.

### **Pacific Blue Australia**

5.24 Pacific Blue Australia said that its B737-800 aircraft would offer up to three tonnes of freight capacity per flight. This aircraft, and the interim B737-300 aircraft, offered more than sufficient space to carry current and projected baggage and freight demand. This contrasted with the limited freight capabilities of the Embraer aircraft. Pacific Blue Australia stated that payload restrictions on the Embraer aircraft operating on the Solomon Islands route meant that freight and baggage had been off-loaded often.

5.25 As with its passenger services, Pacific Blue Australia would be able to offer opportunities to freight forwarders in cities other than Brisbane. The Virgin Group has a long term contract with Toll Corporation. Under this arrangement, Toll would market and sell the belly-hold space on Pacific Blue Australia's services.

#### *Industry Structure*

### **Sky Air World**

5.26 If Sky Air World's application was successful, this would result in the establishment of a new Australian provider of international RPT air services. If Sky Air World was able to grow, this would provide consumers with more choice on other routes.

### **Pacific Blue Australia**

5.27 Pacific Blue Australia noted that it would be entering a market served currently only by foreign airlines. Capture of market share by Australian carriers would have a positive impact on the Australian aviation industry.

#### *Other criteria the Commission considers relevant*

## **Sky Air World**

5.28 Sky Air World referred to the Australian Regional Assistance Mission to the Solomon Islands (RAMSI) involving numerous civilian and Australian Federal Police officials. The implementation of regular and reliable air links between Australia and the Solomon Islands was seen by Sky Air World as vital to the effectiveness of this mission.

### Closing remarks

## **Pacific Blue Australia**

5.29 In concluding its 19 October letter, Pacific Blue Australia suggested that the total capacity requirement for the 2007-08 year would be 498 seats in each direction. This was based on an assumption of traffic generation over current levels and a 70% average seat factor. Pacific Blue Australia considered that two to three flights per week plus capacity from incumbent carriers would be sufficient to cater for demand. With further market stimulation, Pacific Blue Australia said that it would be able to operate its full capacity allocation by late in 2008. Flights would be inaugurated with B737-300 wet-leased aircraft, with the B737-800 replacing it as soon as fleet changes could be made and with projected market growth.

5.30 Pacific Blue Australia said that it was a financially strong and established international airline with a strong market presence and the required capabilities to succeed in thin seasonal markets. It was capable of implementing its capacity allocation successfully within the timeframe sought.

## **6 Summary of submissions received**

### Brisbane Airport Corporation (BAC) – 17 October 2007

6.1 The BAC wrote in support of Pacific Blue Australia's application. The BAC noted that traffic on the Brisbane – Honiara sector, the only city pair served on the Solomon Islands route, had grown at an average of 18% per annum over the past five years. A total of just over 33,000 passengers were carried on the sector in 2006/07.

6.2 BAC set out the benefits it believed would be brought by Pacific Blue Australia. These included a consistent and reliable service, market growth, ease of ticket purchase, connections to other Australian points and Pacific destinations, and the development of tourism and trade as a result of competitive pricing and the new capacity operated.

6.3 The BAC also argued that the B737 aircraft was appropriate to the route and could operate with full passenger and baggage loads. By contrast, the BAC observed that the E170 aircraft was required, because of operational limitations, to fly with payload restrictions. This meant that seats were blocked out and baggage was carried separately. The BAC also noted that Pacific Blue Australia has a number of aircraft in its fleet, providing cover in the event of operational problems, flexibility not available to smaller operators.



6.4 Elaborating on its introductory remarks, the BAC said that Pacific Blue Australia enjoys a high profile within the Australian and Pacific travel industries. The airline has a strong marketing presence, with diverse distribution channels including the internet, call centre and travel agent relationships.

6.5 The BAC pointed to the benefits it said Pacific Blue Australia's entry to other south-west Pacific island destinations had generated. Pacific Blue Australia had brought stable and sustainable air services providing economical air fares supported by its low cost carrier model. The airline's entry to these markets has seen considerable market expansion, for example on the Fiji and Vanuatu routes. The entry of Pacific Blue Australia to the Solomon Islands route would, in the BAC's view, bring benefits to the community and to Australian-based travellers as it had done to other destinations in the region.

6.6 According to the BAC, the ending of conflict in the Solomon Islands in late 2003 provided a basis for economic development, with accompanying growth in trade and passenger numbers to Brisbane. Australian companies have a diversified presence in the Solomon Islands, including mining, forestry, fisheries and tourism. The Solomon Islands' Government has made efforts to increase tourism to the country, building on existing niche markets such as diving and adventure tourism. The provision of additional passenger and associated freight capacity by Pacific Blue Australia, with its economical and reliable services underpinned by technical and commercial capabilities, would assist the continued development of the Solomon Islands.

#### Letters of support

6.7 Sky Air World provided copies of letters of support it had received from the Solomon Islands Ministry of Culture and Tourism (12 November) and from the Ministry of Communications, Aviation and Meteorology (13 November).

## **7 Commission's assessment**

### Introduction

7.1 There is no incumbent Australian passenger carrier operating on the Solomon Islands route, so the start up provisions of the Minister's policy statement are not applicable in this case. Under paragraph 6.2 of the Minister's policy statement, where there are other applications or submissions received about or opposing a proposal, the Commission may apply the additional criteria in paragraph 5 of the policy statement, as well as the paragraph 4 criteria. The Commission will apply both the paragraph 4 and 5 criteria in this case.

### The draft determinations

7.2 On 16 November 2007, the Commission issued draft Determinations [2007] IASC 120 and [2007] IASC 121. In the draft determinations, the Commission proposed to allocate 360 seats per week and 470 seats per week to Pacific Blue Australia and Sky Air World respectively. On 27 November 2007, Pacific Blue Australia responded to the draft determinations advising that it would like to accept the 360 seats allocated. However, Pacific Blue Australia asked the Commission to consider allocating the remaining

available capacity of 40 seats per week to Pacific Blue Australia to enable it to operate a third B737-300 frequency with a slight capacity limitation. (After discussion between the Commission and Pacific Blue Australia, the airline agreed that only a further 20 seats were available beyond the allocations proposed by the Commission in its draft determinations). Pacific Blue Australia also sought the flexibility to introduce its services at its discretion between 31 March and 1 November 2008. The applicant provided additional confidential information in support of its requests for additional capacity and flexibility in the introduction of services.

7.3 Sky Air World also responded to the draft determinations on 27 November. The applicant sought to correct several issues of fact, primarily relating to Sky Air World's operations and aircraft orders. Otherwise, the airline was satisfied with the content of the determinations.

#### **Paragraph 4 assessment**

7.4 Under paragraph 4, the use of Australian entitlements by a carrier that is reasonably capable of obtaining the necessary approvals (4(b)(i)) and of implementing its proposals (4(b)(ii)) is of benefit to the public.

7.5 Pacific Blue Australia is a well established airline which has been operating a network of international services between Australia and destinations in the south-west Pacific region for several years. Accordingly, the Commission considers that Pacific Blue Australia is reasonably capable of obtaining the necessary approvals and of implementing its proposals.

7.6 Sky Air World is a prospective new designated Australian international airline. In line with its normal practice for new applicants, the Commission has conducted a detailed assessment of Sky Air World's claims against the paragraph 4 criteria, as follows.

#### **Necessary approvals**

7.7 In relation to obtaining the necessary approvals, airlines must be designated and obtain licence approval from the Department of Transport and Regional Services (DOTARS) and safety approvals from the CASA before services on a route can commence.

7.8 In accordance with its usual practice for prospective new carriers, the Commission wrote to DOTARS on 17 October 2007, inviting its views about whether it considered Sky Air World to be reasonably capable of obtaining the approvals necessary to operate regular scheduled services. DOTARS responded by letter on 6 November 2007, indicating that it saw no reason why Sky Air World would not be capable of obtaining these approvals. DOTARS noted that the applicant has already achieved significant approvals, namely an Air Operator's Certificate and an approved transport security program and it holds a certificate of compliance in relation to the *Civil Aviation (Carriers' Liability) Act 1959*. DOTARS has also commenced the process of designating Sky Air World to the Government of the Solomon Islands as an Australian designated airline. (DOTARS subsequently advised the Commission that it had completed the process of designating Sky Air World on the Solomon Islands route). Sky Air World has also

received approval to operate a program of passenger charter services on the Brisbane – Honiara sector of behalf of Coral Sea Express, a Solomon Islands-based charterer.

7.9 The Commission notes that Sky Air World has operated a number of international services on the Solomon Islands route, the route involved in its current application for capacity. The initial few months' period of services were operated on the basis of a wet-lease of its E170 aircraft to Solomon Airlines for the provision of services between Brisbane and Honiara. Although this arrangement meant that the airline did not provide the full range of commercial services associated with operating flights in its own right, it demonstrated Sky Air World's operational capabilities.

7.10 Sky Air World subsequently received approval for a series of passenger charter services under its own name on the route during October/November 2007. In doing so, the airline demonstrated its ability to obtain the approvals necessary to operate international charter services. Considering this evidence, together with DOTARS' advice, the Commission is satisfied that Sky Air World is reasonably capable of obtaining the necessary approvals to operate regular scheduled international services on the Solomon Islands route.

#### Implementation of proposals

7.11 In assessing whether a new applicant is reasonably capable of implementing its proposals, the Commission takes account as appropriate of factors such as the qualifications and experience of the applicant's personnel, its specific plans for the route concerned, the applicant's financial situation and market and financial projections for the route concerned.

7.12 Sky Air World has provided the Commission with commercial-in-confidence material supporting its claim that it is capable of implementing international services. As with any start up carrier, there are significant initial costs associated with the establishment of operations. These typically include aircraft deposits and leasing charges and aircraft support expenses, salaries, recruitment and training of staff. Sky Air World has already incurred many of these start-up costs and has operated services on the route in question as outlined above. There is normally a period of low revenues during the establishment phase and this has been the case with Sky Air World.

7.13 Sky Air World plans to introduce a substantial level of capacity into the small Solomon Islands market, representing close to a doubling of the capacity operated by the current foreign carriers. Sky Air World's load factor and profit projections are optimistic, in the Commission's view, because they rely on a substantial level of traffic growth and passenger diversion from existing operators. This is not to say that the projections are not achievable, rather that they are challenging and will require important market assumptions to be borne out in practice. The Commission considers that Pacific Blue Australia's load factor projections are also optimistic.

7.14 Although the market is small, there is likely to be the potential for significant expansion in demand with the introduction of new services with competitive fares and a new product offering. The experience of similar island destinations in the region after the introduction of Pacific Blue Australia's services suggests that this is likely to be the case.

Further, Sky Air World already has some experience of operations into the Solomon Islands and is therefore likely to have developed some understanding of market conditions.

7.15 A factor in determining the likely market growth is the security situation in the Solomon Islands. Fortunately, after a period of some instability on the Solomon Islands, in recent times there has been a return to relatively stable circumstances. However, it make take a little time to convince significant numbers of Australian residents to visit the Solomon Islands in preference to the several other nearby south-west Pacific island nations which may be seen as readily substitutable destinations. However, as Sky Air World pointed out in its application, the presence of RAMSI personnel and the associated need for air links to Australia would provide some level of support for new services, in addition to the more normal underlying and latent travel demand for the route.

7.16 Whether or not Sky Air World is successful in fulfilling its projections will depend on factors such as the attractiveness of its fare offerings, product quality and the effectiveness of its marketing and promotion in generating new traffic and diverting it from existing operators. The cost efficiency of Sky Air World's operations and the extent of competitor responses will also be critical factors. However, the airline is a going concern with aircraft in operation, has already operated on the route in question, offers a two-class product (attractive to the significant business travel component) and appears to have the necessary principal personnel and relevant experience to implement its planned operations. Accordingly, the Commission considers that Sky Air World is reasonably capable of implementing its proposals.

## **Paragraph 5 assessment**

### Assessment against the paragraph 5 criteria

7.17 The Commission's comparative assessment of the respective proposals against the paragraph 5 criteria in the Minister's policy statement of 19 May 2004 is set out below.

7.18 The Commission notes the primacy given to the competition criterion by virtue of paragraph 5.2 of the Minister's policy statement, which says that "In applying all criteria, the Commission should take as the pre-eminent consideration, the competition benefits of each application". The policy statement guides the Commission as to the matters it should have regard to when assessing the applications for their comparative competition benefits, and these are set out as follows:

### Competition Benefits

- (a) In assessing the extent to which applications will contribute to the development of a competitive environment for the provision of international air services, the Commission should have regard to:
  - the need for Australian carriers to be able to compete effectively with one another and the carriers of foreign countries;
  - the number of carriers on a particular route and the existing distribution of capacity between Australian carriers;
  - prospects for lower tariffs, increased choice and frequency of service and innovative product differentiation;

- the extent to which applicants are proposing to provide capacity on aircraft they will operate themselves;
- the provisions of any commercial agreements between an applicant and another carrier affecting services on the route but only to the extent of determining comparative benefits between competing applications;
- any determinations made by the Australian Competition and Consumer Commission or the Australian Competition Tribunal in relation to a carrier using Australian entitlements under a bilateral arrangement on all or part of the route; and
- any decisions or notifications made by the Australian Competition and Consumer Commission in relation to a carrier using Australian entitlements under a bilateral arrangement on all or part of the route.

7.19 The Commission notes that there is no Australian carrier operating scheduled passenger services on the Solomon Islands route. There are two foreign airlines serving the route, predominantly Solomon Airlines with four B737-300 aircraft services per week between Honiara and Brisbane and a fifth B737 service via code sharing on Air Vanuatu's service between Sydney and the Solomon Islands via Vanuatu. Our Airline (formerly Air Nauru) flies twice per week between these two points and this is enroute to Nauru, so only part of the capacity is available for Australia – Solomon Islands passengers. This means that there is only limited competition on the route.

7.20 The entry of services by either Australian applicant would introduce a strong element of competition to the route. Pacific Blue Australia has demonstrated its ability to introduce services successfully and to compete strongly on a range of routes within the south-west Pacific region. It now services several island destinations – Vanuatu, Fiji, the Cook Islands, Tonga and Samoa – as well as the major route between Australia and New Zealand. All of these markets, except the Cook Islands, have seen substantial growth in passenger traffic as a result of the entry of Pacific Blue Australia, with its competitive air fares, quality product offering, well known brand, sales and marketing effort and extensive connections to other Australian domestic cities behind the Australian international gateways.

7.21 Sky Air World has comparatively limited international operating experience. However, the principal flying it has done has been specifically on the Solomon Islands route, so it already has some experience with this market from operational and commercial perspectives. The carrier has been designated by Australia as an international airline for regular scheduled operations on the Solomon Islands route.

7.22 The Minister's policy statement gives preference to proposals involving capacity that the applicants would operate themselves, rather than through other means such as code sharing. In this case, both applicants propose to provide capacity on aircraft they will operate themselves, although Pacific Blue Australia plans to briefly wet-lease B737-300 aircraft until its own B737-800 aircraft become available. The Commission does not see this very short term use of another carrier's aircraft as weakening the Pacific Blue Australia proposal. Neither airline has indicated any plans to code share with other carriers.

7.23 The service offerings proposed by the two applicants are considerably different. Although both plan to operate jet services, they would fly contrasting equipment. Pacific Blue Australia proposes to operate B737 aircraft – initially the smaller capacity B737-300 aircraft, replacing it relatively quickly with the larger B737-800 plane. Similarly Sky Air World intends starting services with the E170, but within a few months plans to replace it with the larger E190.

7.24 Pacific Blue Australia's B737 aircraft (about 138/180 seats for the 300/800 series respectively) are around twice the capacity of Sky Air World's Embraer aircraft (76/94 seats for the E170/190 respectively). As a result, the smaller Embraer aircraft offers scope for a higher frequency service than the B737s can provide, for the same number of seats flown. Thus Sky Air World has proposed a daily service, compared with Pacific Blue Australia's proposal which is for an initial two services per week, rising to four services by late 2008. With the full implementation of both carriers' proposals, similar numbers of seats would be offered, with Pacific Blue Australia operating 720 seats and Sky Air World 658 seats each way each week.

7.25 The frequency advantage offered by Sky Air World is a competitive benefit relative to the Pacific Blue Australia proposal, providing considerable flexibility for travellers through the ability to travel on any day of the week. Combined with Sky Air World's business class offering, this airline has a substantial competitive advantage over Pacific Blue Australia in the business segment, which makes up about 25% of the market.

7.26 The frequency differential is less relevant in the leisure sector, which is less sensitive to day and time of travel. Pacific Blue Australia will have the ability to package leisure visits of varying durations even with two services per week.

7.27 Both carriers offer the prospects of significantly lower fares than are currently offered. The current market structure provides little incentive for price competition, with Our Airline operating only one service per week in competition with Solomon Airlines' five weekly services.

7.28 Sky Air World has set out its proposed fare structure in its application. This shows a considerable range of fare types and levels, providing substantial choice for travellers in terms of price/flexibility trade offs. Sky Air World's proposed fares are well below existing market fares.

7.29 Pacific Blue Australia has not publicly revealed its proposed pricing on the route but says in its public application that its fares will be significantly below those currently available. It also says it would offer a range of fare products suitable to specific market segments. However, Pacific Blue Australia provided pricing information to the Commission on a confidential basis during its presentation in support of its application. The Commission is satisfied on the basis of this presentation, and Pacific Blue Australia's pricing initiatives on similar routes in the south-west Pacific region, that it will offer highly competitive fares supported by strong marketing and promotion of its services.

7.30 An area of some concern with the Sky Air World proposal is that there are payload restrictions resulting from range limitations on the Embraer aircraft on the Honiara – Brisbane sector. This particularly affects the smaller E170. This situation was identified

by Sky Air World itself in its application and noted by Pacific Blue Australia and the Brisbane Airport Corporation in their submissions.

7.31 The limitations should not be such as to mean that more than a few passengers are unable to find a seat on a Sky Air World flight, even if some seats are blocked off for operational reasons. Load factors are unlikely to be high because the volume of traffic on the route is not large and B737 capacity is already provided by foreign international carriers and would be increased if capacity is also allocated to Pacific Blue Australia. Sky Air World's own load factor projections, especially for the initial months of operation, are not high.

7.32 However, there could be some limited restrictions on the carriage of baggage and freight on the Sky Air World aircraft. This is likely to be inconvenient for some travellers and restricts the ability of Sky Air World to offer reliable air freight services. This is a slight competitive weakness in the Sky Air World proposal relative to the Pacific Blue Australia application. However, the situation would be considerably improved once the larger E190 aircraft enters service and this is scheduled to occur within a few months of services commencing. Sky Air World also says that it is examining the possibility of designation of an alternate airport on the Solomon Islands which would ease the problem, but whether this is likely to come to fruition or by when is not clear.

7.33 One of the possible outcomes of the entry of a new Australian carrier or carriers into the Solomon Islands route is the withdrawal of one or both of the foreign carriers. The Commission understands anecdotally that Solomon Airlines financial situation is not strong. Solomon Airlines may be unable to withstand a continued period of fare competition and lower loads, as traffic is diverted from it and its yields would be likely to fall. It may be forced commercially to withdraw relatively quickly. Similarly, Our Airline, which operates only one service per week on the route, would probably maintain its services only for refuelling purposes. In the event that Solomon Airlines exited the market, this would leave a monopoly in place on the route if only one Australian airline was allocated capacity on the route. On the other hand, if both applicants were operating, a competitive situation would remain if foreign carriers were to exit.

7.34 The Commission considers that competition benefits would be maximised through the operation of the available capacity by both Sky Air World and Pacific Blue Australia. Each carrier offers attractive possibilities for the development of competition on the route. The competition gains are likely to be greatest if both carriers enter the route because of the different product offerings, different frequency of operation and scope to compete with each other as well as the existing foreign carriers. Should either of the Australian operators leave the market rather than foreign operators, a competitive situation would still prevail.

7.35 In reaching this conclusion, the Commission has taking account of the Minister's policy statement requirement for the Commission to have regard to the need for Australian carriers to be able to compete effectively with one another, as well as with the carriers of other countries. An important issue for the Commission to weigh up in considering this aspect, is whether dividing the capacity enables both carriers to operate a commercially realistic level of capacity that is broadly consistent with their plans. The Commission considers that this can be achieved with the limitation of 850 seats available for allocation. This is discussed further in the Commission's conclusions.

## Other Benefits

### *Tourism Benefits*

- (b) In assessing the extent to which applications will promote tourism to and within Australia, the Commission should have regard to:
  - the level of promotion, market development and investment proposed by each of the applicants; and route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s).

7.36 The Commission considers that the growth potential for tourism from the Solomon Islands to Australia is substantially less than the scope for expansion in travel from Australia to the Solomon Islands. The Solomon Islands resident component of travel to Australia makes up just over 40% of the origin – destination traffic and only a proportion of this is tourist traffic, with other reasons for travel being visiting friends and relatives, educational purposes and business. The Solomon Islands population is small, at just over 500,000 people and average per capita income is below \$US 500. This contrasts with Australia's much larger population and higher per capita income levels. Accordingly, this criterion carries only modest weight in the Commission's analysis.

7.37 The Commission's view is that Pacific Blue Australia's proposal offers somewhat more potential for the development of the limited tourism market from the Solomon Islands, compared with the Sky Air World proposal. The most significant differentiating factor is Virgin Blue's domestic network behind the Brisbane gateway which enables through-pricing of fares and easy baggage transfer between Pacific Blue Australia international flights and Virgin Blue's Australian domestic services. Sky Air World contends that its flight times are convenient and facilitate easy transfer to other services. However, it does not offer the same inter-connectivity as Pacific Blue Australia.

7.38 On the other hand, Pacific Blue Australia offers a lower frequency than Sky Air World but, as noted above, this is not a major factor in providing travel options for tourists. Pacific Blue Australia should also have the capability for stronger marketing of its services but, within the small Solomon Islands market, Sky Air World should be quite capable of mounting adequate marketing and sales support for its services. Both carriers are likely to offer a range of fare levels and types which are attractive to tourists, although Sky Air World would need to match its fare offering to local market conditions.

### *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).

7.39 There is a significant degree of choice provided by both applicants, despite each planning to operate between the same city pairs. The most notable difference is the contrasting types of equipment to be operated. Pacific Blue Australia plans to operate B737-800 aircraft while Sky Air World would fly Embraer E170 and then E190 jet aircraft. Both operators would be flying modern twin-engined, single aisle jets with similar flying times. However, the differing size of the aircraft, fit out and onboard services mean that there are material differences in the two offerings. The Embraer offers the most differentiated product compared with the existing operators' B737s. It has a smaller cabin but with generous seating space and cabin height. It has two abreast seating and many passengers may prefer this to three abreast seating on the B737.

7.40 Sky Air World's aircraft are also configured with two-classes, and therefore are well equipped to cater for business consumers. The small business class seating capacity (6-8 seats) is appropriate to the modest business travel market. Combined with Sky Air World's higher frequency of operation, this airline offers a clear advantage over Pacific Blue Australia in this market segment.

7.41 Both carriers propose to offer lower fares than currently in the market with a range of fare types. Pacific Blue Australia offers a high standard of onboard service and Sky Air World promises the same.

7.42 As noted earlier, Pacific Blue Australia offers a greater choice of route service options behind Australian gateways. The number of passengers travelling beyond Honiara is likely to be comparatively small. However, Pacific Blue Australia offers the possibility of connecting services with its New Zealand sister company, Pacific Blue New Zealand.

7.43 Both carriers could stimulate competitive responses from the foreign incumbent operators, although this might be limited to improved fare offerings rather than product improvements, at least in the short term.

#### *Trade Benefits*

- (d) In assessing the extent to which applications will promote international trade, the Commission should have regard to:
  - the availability of frequent, low cost, reliable freight movement for Australian exporters and importers.

7.44 Neither carrier would have the carriage of freight as its primary objective. The Solomon Islands is already served regularly from both Brisbane and Cairns by the all-cargo operator HeavyLift Cargo Airlines. This allows for the carriage of large cargo items, including for the RAMSI task force, although the limited frequency of once per week to each of Cairns and Brisbane means that HeavyLift's services are not well suited to time-sensitive and perishable freight. The incumbent foreign airlines address the frequency issue through the ability to carry smaller items in the belly-hold of their B737-300 aircraft. Taking these factors into account, this criterion is given relatively small weighting by the Commission.

7.45 The payload restrictions on the E170 aircraft present a barrier to the carriage of meaningful amounts of loose cargo by Sky Air World. The E190 has a better payload capability but would also be restricted. Although Sky Air World offers a frequency advantage, the expected payload restrictions mean that it is unlikely to be able to guarantee reliable freight movement. Sky Air World says that it is seeking an enhancement of an alternate airport near Honiara. If achieved, this could result in available freight capacity of six tonnes for the E190. At this stage, the Commission regards this development as theoretically possible, but cannot give it weight given the uncertainty.

7.46 By contrast, Pacific Blue Australia's B737 aircraft have no such limitations and can carry up to three tonnes of freight per flight. Pacific Blue Australia plans to use a "whole of Australia" approach to the carriage of cargo. Under a contract with Toll Corporation, Toll would market and sell the belly space on Pacific Blue Australia's services. This arrangement clearly offers the scope for reliable freight movement at competitive rates, although the presence of other operators, including a dedicated freight carrier, means that freight is likely to play a small part in the overall public benefits flowing from new services on the route.

#### *Industry Structure*

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

7.47 The Commission considers that the entry of either carrier would have a positive impact on the Australian aviation industry. Successful participation in the route would contribute to increased employment and other benefits to the Australian aviation industry. Over the longer term, the establishment of a new Australian operator, in Sky Air World, with the Solomon Islands services possibly a key part of its future success, means that the Sky Air World proposal offers the prospect of the greatest positive impact on the Australian aviation industry.

#### Conclusion

7.48 The Commission considers that both Pacific Blue Australia and Sky Air World are reasonably capable of obtaining the necessary approvals and of implementing their proposals. The Commission finds that public benefit is likely to be maximised by the introduction of services by both Pacific Blue Australia and Sky Air World on to the Solomon Islands route, compared with the benefits likely to be available from the entry of one or the other of the applicants alone.

7.49 The introduction of services by both carriers would create a highly competitive environment on the route, with both offering attractive fares and a high quality product. The Solomon Islands market is small but the experience of other island markets suggests that there is scope for rapid market expansion, assuming any safety or security concerns Australians might have about the Solomon Islands can be allayed. Given the amount of capacity that would be brought into the market – about double the current level – substantial traffic generation would be necessary to support all carriers. The addition of both Australian carriers means that a competitive situation would prevail even in the event of the foreign operators exiting, assuming neither Australian carrier was to leave the market. The likely vulnerability of the foreign carriers to aggressive new competition

means that should the Commission allocate capacity to only one of the applicants, there would be a risk of an Australian monopoly developing if the foreign carriers were to leave the route.

7.50 The two applicants also provide distinctly different service offerings. Both will bring modern fast jet aircraft to the route, but with sharply contrasting equipment and different onboard experience. This offers consumers an excellent choice of product. In Sky Air World's case, its smaller Embraer aircraft include a business class offering, which sets it apart from the Pacific Blue Australia product, as well as having a frequency advantage. The service standards on both operators appear to be high and very competitive with the incumbents.

7.51 On the other hand, Pacific Blue Australia offers additional benefits for travellers behind the Brisbane gateway, with the ability to transition passengers easily onto connecting Virgin Blue flights. By contrast, Sky Air World passengers would need to make their own arrangements for connecting services.

7.52 Pacific Blue Australia also has an established brand name with strong sales and marketing support, which should enable it to develop its services quickly. Sky Air World may take longer to achieve significant brand recognition, but it already has some experience in developing the market through its recent series of charter operations. It has committed a substantial sum to marketing its services on the route.

7.53 While the payload restrictions on Sky Air World's aircraft mean that it suffers some commercial limitations, especially in the area of freight, the market share that would be captured by Pacific Blue Australia, means that there are likely to be few instances of passengers being unable to find a Sky Air World seat because of payload difficulties. However, Pacific Blue Australia appears to offer an advantage in the freight area, although this is a comparatively smaller area of public benefit in this market, particularly given the presence of a dedicated scheduled freight carrier in HeavyLift.

7.54 The Commission has split capacity between carriers in previous cases and will do so on this occasion. The Commission is satisfied that doing so will not weaken the opportunities for both carriers to serve the market effectively. Although it may restrict the expansion plans of Pacific Blue Australia in particular, the trade off is greatly enhanced competition and product variety on the route.

7.55 The Commission will allocate to Pacific Blue Australia 360 seats per week. This will enable the airline to implement its planned initial level of two B737-300 services per week. It will also allow for the introduction of B737-800 aircraft to replace the 300 series aircraft as planned during 2008. The operation of a third weekly service proposed by Pacific Blue Australia in responding to the Commission's draft determinations would require agreement between the aeronautical authorities of Australia and the Solomon Islands to ensure that capacity available under the air services arrangements is not exceeded. This is a matter that Pacific Blue Australia can take up with the authorities should it so wish.

7.56 The Commission will allocate 470 seats per week to Sky Air World. This would enable the airline to operate up to six E170 services per week, compared with the seven per week planned. This is likely to be ample for Sky Air World's commercial needs. With the

introduction of the larger E190 aircraft, Sky Air World would be limited to five services per week, but this would still maintain Sky Air World's frequency advantage over Pacific Blue Australia.

7.57 In total, the Commission's allocations mean that slightly more seats could be put into the market than the maximum sought by Pacific Blue Australia (720 per week) or Sky Air World (658 per week) alone. This is likely to provide ample capacity for the needs of the market for some time to come, even allowing for substantial growth in market demand.

7.58 The Minister's policy statement gives the Commission discretion in specifying a period within which a carrier must fully utilise allocated capacity. The Commission has generally provided flexibility for carriers in fully utilising allocated capacity, particularly on new routes. In this case, recognising that a substantial amount of capacity is to be allocated by these determinations, and that it will take some time to develop the size of the market, the Commission will give both carriers considerable lead time in which to fully utilise their capacity. The Commission is agreeable to Pacific Blue Australia's request for greater flexibility in the introduction of services than was proposed in the draft determinations. The Commission will grant similar additional flexibility to Sky Air World.

7.59 The Commission will require both Pacific Blue Australia and Sky Air World to fully utilise their allocated capacity by 31 October 2009. Should it become apparent that either carrier is unlikely to comply with this condition, the Commission would encourage the prompt return of any unused capacity. Failing this, the Commission may initiate a review process to ensure that the capacity does not remain unused for longer than necessary. In line with its normal practice in allocating capacity to start-up carriers, the Commission's will make an interim – three year – determination in favour of Sky Air World.

## **8 Determination allocating capacity on the Solomon Islands route to Pacific Blue Australia (Australia) Pty Ltd ([2007] IASC 120)**

8.1 The Commission issues a determination in favour of Pacific Blue Australia, allocating 360 seats per week on the Australia – Solomon Islands route, in accordance with the Australia – Solomon Islands air services arrangements.

8.2 The determination is for five years from the date of the determination.

8.3 The determination is subject to the following conditions:

- Pacific Blue Australia is required to fully utilise the capacity from no later than 31 October 2009 or from such other date approved by the Commission;
- only Pacific Blue Australia is permitted to utilise the capacity;
- Pacific Blue Australia is not permitted to utilise the capacity to provide services jointly with another Australian carrier or any other person without the approval of the Commission;

- changes in relation to the ownership and control of Pacific Blue Australia are permitted except to the extent that any change:
  - results in the designation of the airline as an Australian carrier under the Australia – Solomon Islands air services arrangements being withdrawn; or
  - has the effect that another Australian carrier, or a person (or group of persons) having substantial ownership or effective control of another Australian carrier, would take substantial ownership of Pacific Blue Australia or be in a position to exercise effective control of Pacific Blue Australia, without the prior consent of the Commission; and
- changes in relation to the management, status or location of operations and head office of Pacific Blue Australia are permitted except to the extent that any change would result in the airline ceasing to be an airline designated by the Australian Government for the purposes of the Australia – Solomon Islands air services arrangements.

## **9 Interim Determination allocating capacity on the Solomon Islands route to Sky Air World Pty Ltd ([2007] IASC 121)**

9.1 The Commission issues an interim determination in favour of Sky Air World, allocating 470 seats per week on the Australia – Solomon Islands route, in accordance with the Australia – Solomon Islands air services arrangements.

9.2 The determination is for three years from the date of the determination.

9.3 The determination is subject to the following conditions:

- Sky Air World is required to fully utilise the capacity from no later than 31 October 2009 or from such other date approved by the Commission;
- only Sky Air World is permitted to utilise the capacity;
- Sky Air World is not permitted to utilise the capacity to provide services jointly with another Australian carrier or any other person without the approval of the Commission;
- changes in relation to the ownership and control of Sky Air World are permitted except to the extent that any change:
  - results in the designation of the airline as an Australian carrier under the Australia – Solomon Islands air services arrangements being withdrawn; or
  - has the effect that another Australian carrier, or a person (or group of persons) having substantial ownership or effective control of another Australian carrier, would take substantial ownership of Sky Air World or be

in a position to exercise effective control of Sky Air World, without the prior consent of the Commission; and

- changes in relation to the management, status or location of operations and head office of Sky Air World are permitted except to the extent that any change would result in the airline ceasing to be an airline designated by the Australian Government for the purposes of the Australia – Solomon Islands air services arrangements.

Dated 10 December 2007

John Martin  
Chairman

Philippa Stone  
Member

Ian Smith  
Member