Australian Government

International Air Services Commission

DECISION

Decision:	**[2012] IASC 215**
Variation of:	**[2011] IASC 132**
The route:	**Papua New Guinea (PNG)**
The applicant	**Qantas Airways Limited (ACN 009 661 901) (Qantas)**
Public Register File:	**IASC/APP/201205**

1 The application and submissions

1.1 On 27 February 2012, Qantas applied for a variation to Determination [2011] IASC 132 (the Determination), which allocates 1,000 seats of capacity per week on the PNG route, that would enable the airline to continue code sharing arrangements on Air Niugini services from Port Moresby to Sydney and Brisbane. Qantas has sought authorisation of the code share arrangements until 30 June 2017. Qantas' application includes a confidential attachment.

1.2 Qantas maintains that the code share creates a competitive dynamic between it and Air Niugini and that the presence of other competitors and potential for new entry continue to act as a competitive constraint on both airlines. Qantas says that absent the code share the likely outcome would be a reduction in the number of services and competitors on the code share routes and that the code share ensures that Air Niugini remains as an operator and key competitor in the market. Qantas says that the new code share arrangement is purely hard block, which amplifies the risk to Qantas and mitigates the risk to Air Niugini which now has a guaranteed and fixed income stream for each flight. According to Qantas, the presence of the B767 aircraft on the route is crucial for the efficient carriage of palletised and containerised freight. Qantas says it is seeking a five year reauthorisation to provide investment certainty.

1.3 A summary of the Qantas application is at **Attachment A**.

1.4 On 1 March 2012, the Commission published a notice inviting submissions about the application. The Australian Competition and Consumer Commission (ACCC) made a submission on 16 March 2012 and Air Niugini made a submission on 10 April 2012. A summary of the submissions is at **Attachment B**. The Commission has considered both submissions and will refer to them where relevant.

1.5 All public material supplied by the applicant and submitters is filed on the Register of Public Documents. Confidential material supplied by Qantas is filed on the Commission's confidential register.

1.6 The Commission has analysed a considerable amount of data to assess any changes to the competitive environment and public benefit situation on the route since its 2009 review. The data includes information held by government agencies such as the

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Australian Bureau of Statistics and the Bureau of Infrastructure, Transport and Regional Economics; commercial-in-confidence material provided by Qantas; and fare information available on web sites.

2 Requirements under the Act and the Minister's policy statement

2.1 Under section 15(2)(e) of the *International Air Services Commission Act 1992* (IASC Act), a carrier cannot use allocated capacity to provide joint services with another carrier without the prior approval of the Commission. Qantas, therefore, requires the Commission's authorisation to use its allocation of capacity to code share on Air Niugini services.

2.2 When considering applications to vary determinations, the Commission must decide whether the determinations, as varied, would be of benefit to the public. The Minister's policy statement makes it clear that where capacity can be used for code sharing under air services arrangements, the Commission would generally be expected to authorise applications for use of capacity to code share. The policy statement goes on to state that if the Commission has serious concerns that a code share application may not be of benefit to the public, it may subject the application to a more detailed assessment using the paragraph 5 criteria. Before doing so, the Commission must consult the ACCC and it has done so in this case.

2.3 On previous occasions when the Commission has considered applications for Qantas to code share on Air Niugini, it has had concerns about the impact of the code share on competition on the route. At the same time, the Commission has considered the implications for competition, and for Air Niugini, if the code share were not approved. In the Commission's view these considerations remain relevant and for this reason the Commission has again decided to assess the application against the paragraph 5 criteria.

2.4 The paragraph 5 criteria comprise competition, tourism, consumer, trade, and aviation industry benefits and any other criteria that the Commission may consider relevant. The Minister's policy statement states that the Commission is not obliged to apply all the paragraph 5 criteria, and that in applying the criteria it should take as the preeminent consideration the competition benefits of the application.

2.5 The Commission notes that Qantas has addressed all the paragraph 5 criteria and will therefore assess its application against all the criteria. In doing so, the Commission has taken as its preeminent consideration competition benefits.

3 The code share agreement

<u>The nature of the code share agreement</u>

3.1 Qantas and Air Niugini amended the code share arrangements on 25 March 2012. A copy of the amended agreement has been provided to the Commission.

3.2 The amended arrangements do not contain the soft block component which had been a feature of earlier arrangements. In other respects the amended arrangements are similar to the previous arrangements. Qantas is required to purchase the same number of seats for each month of a scheduling period which means that it cannot adjust capacity to reflect seasonal variations within a scheduling period. As under the previous arrangements, within the fixed number of monthly seats that Qantas purchases, there are variations in the numbers it purchases for each day of the week. Qantas maintains that this is essential to meet significant and long-established fluctuations in the size of the market on each day of week.

3.3 In its 2007 and 2009 decisions, the Commission was critical of the soft block component which has now been removed. Its concerns about the earlier arrangements went beyond this, however. They related to the small size of the hard block and Qantas' ability to tailor its supply to underlying demand which varies by day of the week and direction of travel.

Previous decisions by the IASC

3.4 In its original decision in August 2002 the Commission commented that, at first glance, the code share would be of detriment to the public because it would mean a loss of Qantas' services, and with no third country carriers on the route, Qantas and Air Niugini would be under little pressure to price aggressively. More importantly, however, the Commission considered that the code share should ensure the continuation of Air Niugini's services, the loss of which would be likely to lead to a far greater loss of public benefit than under the code share arrangement.

3.5 In both the November 2007 and December 2009 decisions the Commission commented that the code share favoured Qantas through its ability to match the supply of seats to daily demand variations, leaving Air Niugini to sell a higher number of seats on days of weak demand. This placed Air Niugini under more pressure to price competitively to sell its seats than Qantas. The decisions also criticised the soft block element of the arrangements that gave Qantas the option of buying or not buying extra seats, depending on whether the hard block was likely to be fully sold. The Commission considered that the ability to match supply to day to day demand enabled Qantas to generate strong returns without the need to discount significantly. The Commission said that the arrangements would be more competitive if the Qantas hard block seat numbers were larger and more uniform across flights, with smaller or no soft block components.

3.6 In its 2007 decision the Commission said that if the approval were not continued, Qantas would almost certainly re-enter the Sydney and Brisbane sectors. It concluded that, in the short term, there could be higher public benefits as Qantas re-entered the market in its own right, with air fares falling as carriers fought for market share. However, within a relatively short time, there would probably be a rationalisation of services, with small carriers exiting and Air Niugini reducing its frequencies, leading to higher fares. The Commission noted that the code share had played an important role in maintaining wide bodied B767 services on the route, with the capacity to move large freight items in containers and on pallets.

3.7 In its 2009 decision the Commission commented that the entry of Pacific Blue (in 2008) had provided an important competitive presence and that there was scope for it to establish itself more strongly in the market and to deliver a product that would better appeal to the key business market. The 2009 decision reiterated comments in the 2007 decision about the importance of maintaining B767 services for freight and the risks associated with Qantas re-entering the market in its own right if the code share were not approved. The Commission said that at the time of the next review it would expect to see a much better match between the volume of seat purchases by Qantas across the week and in both directions in order to improve the competitive situation. It said it would regard this as a significant factor in its decision making at the next review.

Decision by the PNG Independent Consumer and Competition Commission (ICCC)

3.8 In December 2009 the PNG ICCC approved the code share until 30 June 2012. While it had serious concerns about the code share being skewed in Qantas' favour and putting little pressure on Qantas to price competitively against Air Niugini, it concluded that declining the application would be likely to result in less competition. It said that because of the high yields it was enjoying, Qantas was likely to enter the market in its own right. It envisaged more competition in the short term, in the form of a price war, but in the medium term, it thought Air Niugini would be likely to withdraw completely from the Brisbane and Sydney routes. The result would be Qantas emerging as the monopoly operator on the Sydney route and as the more dominant operator over Pacific Blue on the Brisbane route.

3.9 Another concern of the ICCC was the substantial reduction in freight capacity and increased freight rates that would occur as a result of the loss of Air Niugini's wide bodied B767, and the effect this would have on PNG exports and businesses reliant on air freight and on the broader PNG economy.

3.10 A condition of the approval was that unless, within 12 months, the code share had been revised to provide a substantial reduction in soft block capacity, with a commensurate increase in the hard block component, the Commission would consider whether to review the authorisation.

3.11 Air Niugini has applied to the ICCC for an extension of the code share and the Commission and the ICCC have been consulting on their approaches to the respective applications.

4 Services and traffic on the route

Current services between Australia and PNG

4.1 Air Niugini operates two B767 services per week between Port Moresby and Sydney (one via Brisbane) and eight B767 services per week between Port Moresby and Brisbane. Qantas code shares on all these services, with the number of its code share seats ranging between some 30 and 90 per flight (the B767 has 215 seats).

4.2 Air Niugini also operates three F28 services between Port Moresby and Brisbane and nine F28 and DH4 services between Port Moresby and Cairns. Qantas does not code share on these services. Qantas operates 12 Dash8 services per week between Port Moresby and Cairns.

4.3 Virgin Australia operates five B737-800 services per week between Port Moresby and Brisbane (the fifth service was introduced on 26 March 2012). Airlines of PNG code shares on these services.

4.4 Airlines of PNG operates two Dash 8 services between Port Moresby and Cairns. Virgin Australia does not code share on these services.

4.5 Pacific Air Express operates three B737-300F (17.5 tonnes capacity) freight services between Port Moresby and Brisbane.

4.6 There are no third country carriers operating on the route.

Characteristics of the route

4.7 PNG is Australia's 21st largest international route. In 2011 266,012 origin/destination passengers (an average of 2,558 each way each week) travelled between the two countries. Only about 5% of passengers travelling between Australia and PNG have an origin or destination behind or beyond the two countries (through passengers).

4.8 After falling by nearly 30% between 1999 and 2004, traffic has been growing strongly in the years since, averaging 12.4% annually over the last five years.

4.9 Brisbane, with 54.3%, and Cairns, with 37.7%, are by far the largest ports of clearance for origin/destination traffic, with only 7% travelling to and from Sydney.

4.10 In 2011 Australian residents made up 61% of the two way traffic. Most Australian residents visiting PNG did so for business (40.7%) and 28.1% gave employment as their reason for travel. As employment is linked to business activity, this means that business related travel accounted for nearly 70% of all travel undertaken by Australian residents, up from 58% in 2008. Holiday traffic accounted for 13.8% of Australians visiting PNG. 18.3% of PNG residents travelling to Australia did so for business, with 38.9% travelling for holiday and 17.2% to visit friends and relatives. Other reasons for travel included education and conventions.

4.11 The route is quite seasonal, with July the strongest month in 2011 (24,787 passengers) and February the weakest (17,958 passengers). February through to May seems to be the low season, with traffic generally strongest from June through to January.

4.12 In 2011 the airline share of Australia-PNG origin/destination traffic (including Cairns) was Air Niugini 52.5%, Qantas 22.7%, Virgin 12.4% and Airlines of PNG 6.4%. Virgin Australia's share was 13.2% in 2009 and 15.2% in 2010. Airlines of PNG's share has been falling steadily since 2007 when it was 22.5%.

5 The Commission's assessment against the paragraph 5 criteria

Competition Benefits

5.1 In terms of competition benefits, paragraph 5 of the Minister's statement provides:

"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."

<u>The competitive environment</u>

5.2 Since first approving the code share in 2002 on the Sydney and Brisbane sectors, the Commission has had concerns about the possible implications of the code share for competition on the route. There have never been any third-country carriers operating on the route which could provide competition for Qantas and Air Niugini, and given the close geographic proximity of the two countries, such entry seems unlikely.

5.3 Since 2002 the competitive environment has improved. While initially four Qantas B767 Port Moresby-Brisbane-Sydney services were discontinued, since 2002, Air Niugini has introduced direct Port Moresby-Sydney services for the first time and nearly doubled the number of seats and frequencies it operates on the Sydney and Brisbane sectors. Airlines of PNG entered the route in 2005 and Qantas began services between Cairns and Port Moresby in 2010. Most significantly, in 2008 Pacific Blue (now Virgin Australia) began services on the Brisbane route. Moreover, Virgin Australia has recently increased its B737-800 services from four to five per week. This suggests that the code share is not acting as an impediment to new entry or expansion.

5.4 Confidential data provided by Qantas shows that it obtains high passenger revenue yields on the Brisbane and Sydney sectors of the PNG route. This likely reflects the unusually high proportion of business and employment related traffic on the route, upwards of 70% of all Australian origin traffic. While not all, or even most, of these passengers would travel business class, given the time sensitive nature of their travel needs it seems likely that fares paid by non-business class passengers would generally be at the higher end of the economy class range. While the code share may be a factor in maintaining these high yields, the Commission accepts that yields are always likely to be high on this route given its characteristics.

5.5 From fare information available on on-line web sites, it appears that there are only marginal differences between the lowest economy fares offered by Qantas, Air Niugini and Virgin Australia. Qantas' business class fares, however, are between 25% and 30% higher than those offered by Air Niugini. Virgin Australia has a premium economy, but not a business class fare. Virgin's premium economy fare seems to be about a third the Qantas business class fare.

5.6 Higher fares do not seem to have been an impediment to Qantas capturing a substantial portion of the business market, as evidenced by its high yields and profits on the route. This could be due to several factors, including Qantas' ability to match supply to forecast demand under the code share arrangements, corporate travel contracts and, as indicated in Air Niugini's submission, access to more substantial marketing resources and its ability to offer connectivity to its large domestic and international networks. Whatever the reason, while business passengers generally are not as price sensitive as leisure passengers, they do at least have the choice of much cheaper fares on Air Niugini for what is effectively the same product.

5.7 With the predominance of business related traffic on the route, high fares appear not to have been an impediment to growth. This would seem to be borne out by the strong upward trend in traffic in recent years.

The counterfactual

5.8 A critical issue for the Commission to consider is the counterfactual – that is comparing the likely state of competition on the route with and without the code share in place.

5.9 In the Commission's view, were the code share to be approved the state of competition would either remain unchanged or, if recent trends continue, could increase. Increased competition would depend on how successful Virgin Australia is in establishing itself on the route and what effect, if any, removal of the soft block component from the code share has on competition between Air Niugini and Qantas.

5.10 This is a highly profitable route for Qantas and traffic on the route has been growing strongly in recent years. Were the code share application to be rejected, the Commission has no reason to doubt that Qantas would re-enter the route with its own aircraft, in direct competition with Air Niugini and Virgin Australia, a view shared by Air Niugini. While in the short term this would be likely to result in lower fares as airlines compete for market share, Qantas would, in the Commission's view, be likely to emerge as the strongest competitor. In such a situation Air Niugini would be forced to reduce services and possibly leave the route, resulting in a reduction in competition. There would also be implications for Air Niugini's future viability and for the broader PNG economy, as outlined in Air Niugini's submission.

Other Benefits

5.11 In terms of tourism benefits, paragraph 5 of the Minister's policy statement provides:

> "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)."

5.12 PNG's small population and low average incomes means that PNG's potential as a target market for tourism to Australia is limited and is unlikely to increase significantly in the foreseeable future. However, to the extent that the code share keeps Air Niugini in the market and provides some price competition, it is likely to be a positive factor in the development of the small market that does exist. Overall, the Commission considers that in the case of PNG the tourism criterion is not a significant factor in assessing the application.

5.13 In terms of consumer benefits, paragraph 5 of the Minister's policy statement provides:

> "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)."

5.14 There is little evidence that consumers have benefited from lower fares as a result of the code share. Qantas' yields on both the Brisbane and Sydney routes have been consistently high. On a route with such a high proportion of business related traffic, however, frequency and choice of service are probably more important for most passengers. Although the total number of services on the route fell when Qantas withdrew from the route in 2002, there has been a steady increase in the number of weekly operated seats and frequencies on the route since. Also, non-stop services between Sydney and Port Moresby have been introduced. The entry of Virgin Australia, in alliance with Airlines of PNG, onto the Brisbane route has provided a wider range of fare types and levels, and potentially greater price competition, compared to when the code share arrangements were first approved in 2002. The additional carriers also provide consumers with a wider choice of travel times and in-flight service.

5.15 In terms of trade benefits, the Minister's policy statement provides:

> "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."

5.16 Qantas purchases about half the freight space available on all Air Niugini's B767 Brisbane and Sydney services on a hard block basis. Qantas then sells this cargo space under Air Niugini's code, and has the option of taking additional space on a soft block basis. Qantas says that the B767 aircraft is crucial because it has substantially more freight carrying capacity than the B737 and takes palletised and containerised freight.

5.17 The loss of the B767 aircraft as a result of the code share being rejected would be significant, both for Australian exporters and for PNG businesses reliant on Australian imports. While there is some dedicated freight capacity on the route, passenger carriers have the ability to offer air freight services at a lower incremental cost. Because of its ability to carry containerised and palletised cargo, the B767 is much more competitive with dedicated freight aircraft than the B737 and is therefore more likely to place downward pressure on freight rates, as well as provide substantial additional freight capacity. The Commission notes the comments by Air Niugini on the importance of wide body services to PNG exporters and importers and to the broader PNG economy.

5.18 The Commission concludes that the continuation of B767 services is important to maintaining frequent, low cost and substantial freight capacity between the two countries, and also between PNG and markets in Asia.

5.19 In terms of industry structure, the Minister's policy statement provides:

> "The Commission should assess the extent to which applications will impact positively on the Australian aviation industry."

5.20 Were Qantas to return to the route in its own right as a result of the code share being discontinued, this would likely have a negative impact on Qantas' profits and the competitive environment for Virgin Australia could become more difficult. Therefore, discontinuing the code share could result in lower profits for the Australian aviation industry overall.

5.21 While the code share means that Qantas flight crews no longer fly the route, it seems unlikely that this would have had any discernible impact on employment levels.

6 Conclusion

6.1 In all its previous decisions on the code share arrangements the Commission has taken the view that the situation would probably be worse, from the point of view of competition and other public benefits, if the code share were not approved. The initial decision in 2002 helped restore Air Niugini to sound financial health, although in the early years this seemed to come at the cost of reduced competition, with only one carrier on the route and reduced services to Sydney. The combined hard block/soft block nature of the code share arrangements provided only limited incentive for competition between Qantas and Air Niugini. In its 2007 and 2009 decisions the Commission found that the variation in the number of hard block seats purchased by Qantas to reflect daily demand patterns enabled it to sell its seats without the need to discount fares significantly, especially in business class.

6.2 In more recent years, the competitive environment has improved with first Airlines of PNG and later Pacific Blue (Virgin Australia) entering the route, as well as Air Niugini nearly doubling its capacity since 2002. While there is little evidence yet that this increased competition has put downward pressure on fares, the potential is there, in particular if Virgin Australia continues to expand and begins to make inroads into the business market. In any event, price is perhaps less important for most passengers on this route than on other routes which do not have the same levels of business traffic.

6.3 Above all the Commission is concerned that rejection of the code share could result in less competition than currently exists. In the short-term, there could be higher public benefits as Qantas re-enters the market in its own right, increasing choice of carrier and frequency on the route and lowering fares. However, within a relatively short time there would probably be a rationalisation of operations, with some of Qantas' competitors, including Air Niugini, reducing services and possibly leaving the route.

6.4 In 2007 and 2009 the code share arrangements were approved for shorter periods than those requested by Qantas. The code share has been in place for ten years and over the latter half of that period there has not been a lessening of competition. Moreover, the soft block component, a previous cause for concern, has been removed. While the Commission remains concerned that by allowing Qantas to match flight seat numbers to forecast demand to some extent, the arrangement puts limited pressure on Qantas to compete on price with its code share partner, the Commission considers that the code share is preferable to the alternative without the code share. For these reasons the code share will approved.

7 Role of the ACCC

7.1 The Minister's Policy Statement and its associated Explanatory Memorandum make it clear that the ACCC retains primary responsibility for competition policy matters. Nothing in the Commission's decisions should be taken as indicating either approval or disapproval by the ACCC. The Commission's decisions are made without prejudicing, in any way, possible future consideration of code share operations by the ACCC.

8 Decision ([2012] IASC 215)

8.1 In accordance with section 24(1) of the Act, the Commission varies Determination [2011] IASC 132 by adding the following conditions:

- the capacity may be used by Qantas to provide services jointly with Air Niugini until 30 June 2017 in accordance with:
  - the code share agreement dated 30 August 2002, as amended;
  - or any subsequent code share agreement between Qantas and Air Niugini for operations on the Australia – PNG route with the prior approval of the Commission;
- under any code share agreement with Air Niugini:
  - Qantas must price and sell its services on the route independently of Air Niugini; and

- Qantas must not share or pool revenues on the route with Air Niugini; and

- nothing in this decision exempts Qantas from complying with the Australian Consumer Law. The airlines are required to take all reasonable steps to ensure that passengers are informed, at the time of booking, of the carrier actually operating the flight.

Dated: 28 June 2012

Jill Walker
Chairwoman

Stephen Bartos
Member

Attachment A

Summary of the application

Qantas has made the following claims in support of its application in its public submission:

- Continuation of the code share arrangements offers the best prospect of viable operations on the Port Moresby – Brisbane and Port Moresby - Sydney routes and maximisation of the public benefit by maintaining vigorous and effective competition between Qantas and Air Niugini.
- The arrangements have continued to provide significant public benefits in the form of efficiencies and lower operating costs, which have in turn provided a wider range of services and networks than could be provided by each carrier operating independently.
- The arrangements have resulted in trade benefits for Australia, including tourism benefits, by stimulating market growth between the two countries, despite the volume of traffic between Australia and PNG being small and having limited growth capability.
- Qantas prices and sells its services on the route entirely independently of Air Niugini, creating a genuinely competitive dynamic on the route. In addition, the presence of other competitors and the potential for new entry, continue to act as a real competitive constraint on both Qantas and Air Niugini.
- Since the last Decision to authorise the code share, overall capacity of the four direct operators on services between Australia and PNG has grown by 29%.
- Absent the code share arrangements, the more likely outcome would be a reduction in the number of services and competitors on the code share routes and the flow on effects of reduced capacity, less flexible scheduling and a more limited range of fares for consumers.
- Qantas believes the application fully meets the paragraph 5 criteria in the Minister's policy statement. Specifically:
    - Since the code share arrangement was expanded in 2002, the number of direct carriers on the code share routes has doubled with Pacific Blue and Airlines PNG entering the market.
    - The arrangements ensure that Air Niugini remains an operator and key competitor in the market.

- Sufficient unallocated capacity is available under the Air Services Agreement to ensure a commercially viable level of start-up capacity. As a result, new entry is a possibility.

- The structure of the hard block code share arrangements means that Qantas and Air Niugini must be highly competitive to maximise returns as each airline independently sets it prices, determines its fares and rules attached to each fare, operates its own yield management systems, and sells its products through its own sales networks.

- The frequency and schedule choice between Australia and PNG could not be matched if Qantas and Air Niugini operated in the absence of the code share arrangement.

- The characteristics of the PNG economy and its small population limit the promotion of inbound tourism to Australia.

- Efficiencies derived from the code share arrangements have delivered a range of consumer benefits on the PNG route including: increased frequency and capacity; larger and more modern aircraft; a wider range of competitive fares; direct services between Port Moresby and Sydney; and access to convenient connections on the extensive domestic and international networks of both carriers.

- Under the code share arrangements Qantas purchases half the belly hold cargo space. This has delivered competition in the freight market on eight B767 services per week between Brisbane and Port Moresby and two B767 services per week between Sydney and Port Moresby. Only Air Niugini operates B767 services, which allow for the carriage of containerised and palletised freight.

- The arrangements have had a positive effect on the Australian aviation industry by producing profits for Qantas that have enabled it to introduce own-operated services (on the Port Moresby – Cairns route). This benefits Qantas and ancillary aviation business related to Qantas' operations.

- The arrangements have also had a positive effect on Air Niugini as they have supported the ongoing viability of their operations in an increasingly competitive market.

- The continued presence and growth of the code share routes would have encouraged the entry of Airlines PNG and Pacific Blue in 2005 and 2008 respectively.

Attachment B

Summary of submissions

The Australian Competition and Consumer Commission (ACCC) (16 March 2012)

The ACCC suggests that given business travel makes up an unusually high proportion of Australia-PNG traffic compared to other routes, it may be relevant for the IASC to consider the public benefits and/or competition effects of the code share for separate customer segments, but with a particular focus on business travel.

The ACCC notes that the counterfactual in this case appears complex and somewhat uncertain. The ACCC has not reached a concluded view on most likely counterfactual, and says this will ultimately be a question for the IASC. In this context the ACCC notes that it may be relevant to take into account the circumstances in which the code share originally arose following financial difficulties faced by Air Niugini and the withdrawal by Qantas of its services.

The ACCC notes Qantas' submission that the code share is integral to the continued operations of B767 aircraft, with significant freight capacity. It may be relevant for the IASC to consider the likelihood of such services continuing with and without the code share.

The ACCC has previously found that barriers to entry are relatively high in the aviation sector. It notes sustained and apparently successful entry on this route, albeit on a small scale, namely by Virgin and Airlines PNG. It may be relevant to consider the impact these entrants have had on the route and the degree to which they have been successful in winning and/or increasing market share.

Given the uncertainty around the likely counterfactual and the potential competition issues, the ACCC suggests that if the IASC is minded to approve the code share, it may be appropriate to consider a further short term period.

The ACCC acknowledges the concerns raised in the IASC 2009 decision about the hard block element of the code share and encourages the IASC to explore this and to take into consideration Air Niugini's views.

Air Niugini (10 April 2011)

Air Niugini says that without the code share the number of carriers on the route would decrease and the use of wide bodied aircraft would disappear. This would have a deleterious effect on the PNG economy, increasing the freight costs and causing PNG airlines to shrink and become less viable.

According to Air Niugini, if the code share were not approved Qantas would recommence services, but without the support of a code share partner demand would be insufficient to support high frequency wide body services. To achieve a competitive level of frequency Qantas would be likely to use a narrow body aircraft. The introduction of such a service would introduce substantially more capacity than that lost to Qantas under the code share. In the short term this would result in price reductions and a battle for market share.

In such a battle, Air Niugini says that Qantas holds a number of advantages over it, including access to more substantial marketing resources and an ability to offer discounts on a wide network of domestic and international routes. Air Niugini says it doesn't have the financial resources to "tough out" a sustained battle for market share with Qantas. It would need to substantially reduce its wide body services on the route, and even then losses would be likely and it would be forced to restructure to narrow body aircraft.

According to Air Niugini, government backing means that it would ultimately survive, but government assistance would be at the expense of most needed investment in health, education and infrastructure. Airlines of PNG, which has neither the financial resources of Qantas nor the ultimate government backing of Air Niugini, and Virgin would face significant competitive pressure and Air Niugini predicts that their code share would not survive and that both would leave the route.

Air Niugini says removal of wide body operations would increase freight costs between PNG and both Australia and Asia. The PNG economy is highly dependent on air freight services and the of loss direct wide body services would affect both importers and exporters and potentially be devastating for highly perishable seafood exports.

Air Niugini says that since December 2011, the code share agreement only provides for the purchasing of hard block seats. These are often higher than the number Qantas sells, so any unsold seat represents an absolute loss to Qantas. This is a substantial change to the code share and responds to concerns raised by the PNG competition regulator.

According to Air Niugini, through independent pricing and marketing, the code share results in a high level of competition between carriers, with Air Niugini's fares having reduced significantly on every code share route. There are four carriers marketing and selling seats on two operating carriers and APNG/Virgin have captured a sustainable percentage of the market. Without the code share there would likely be two carriers, Qantas and Air Niugini, and neither would operate wide body aircraft.

Air Niugini says that loss of the code share could result in increases in domestic fares and a reduced ability for the airline to continue to serve loss making or marginal domestic routes which are provided as a community service obligation. There would also be a direct loss of at least 500 Air Niugini jobs almost immediately and more likely to follow.

Attachment C

Relevant provisions in the bilateral air services arrangements

The use of code sharing to utilise capacity allocated by the Commission is consistent with the provisions of the Australia - PNG air services arrangements. Capacity marketed by Qantas under its designator on services operated by Air Niugini counts as the exercise of Australian capacity entitlements under the air service arrangements.