14 September 2016

Ms Marlene Tucker
Executive Director
International Air Services Commission
GPO Box 630
Canberra ACT 2601

Dear Ms Tucker,

Supplementary Application – Papua New Guinea

Thank you for the Commission's letter of 30 August 2016 which invited Qantas to provide a supplementary application addressing the criteria set out in Paragraph 5 of the Minister's Policy Statement, in relation to proposed code sharing arrangements with Air Niugini on the Papua New Guinea route. Our supplementary application is outlined in the Attachment to this letter.

We would be pleased to provide any further information the Commission might require in considering our application.

Yours sincerely,

Tony Wheelens
Executive Manager, International and Industry Affairs

Qantas Airways Limited ABN 16 009 661 901
10 Bourke Road Mascot NSW 2020 Australia
Telephone +61 2 9691 3636

qantas.com

ATTACHMENT

Code sharing arrangements between Qantas and Air Niugini on the Papua New Guinea route have been in place since 1987 and have been instrumental in maintaining and growing air services in a historically challenging market, dominated by corporate traffic flows, with relatively limited opportunities for tourism growth. Against this background, the code share arrangements have delivered significant public benefits in the form of increased competition, efficiencies and lower operating costs, which have in turn provided a wider range of services and choice for consumers than could be provided by each carrier operating alone.

Following Qantas' independent decision to operate a daily service between Brisbane and Port Moresby from 30 October 2016, in lieu of services between Cairns and Port Moresby, Air Niugini and Qantas have changed the structure of their code sharing arrangements on the Papua New Guinea route to a more sustainable model which better reflects the dynamics of the market and which will continue to provide public benefits to consumers.

Papua New Guinea's Independent Competition and Consumer Commission (ICCC) approved the passenger code share and freight arrangements on the Brisbane and Sydney routes on 19 August 2016. A request for authorisation of the passenger code share on the Cairns route was made under a separate application and is currently under consideration by the ICCC.

Paragraph 5 Criteria – Minister's Policy Statement

The Minister's Policy Statement provides that 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:

<u>5.1 (a) Competition Benefits</u>

- The proposed code share arrangements are consistent with and provided for under the air services arrangements between Australia and Papua New Guinea. These commercial entitlements should be readily accessible by carriers to compete with existing carriers in the market or potential carriers to whom equivalent rights may be available.
- The Papua New Guinea market has historically accommodated 3-4 carriers operating under some form of commercial agreement (predominantly codeshare arrangements).
- Virgin Australia commenced services on the Brisbane route in November 2008 under a codeshare arrangement with Airlines PNG (now PNG Air) which subsequently ceased its own operations on the market in July 2014 resulting in a 3 per cent reduction in Brisbane-Port Moresby market capacity (FY15 v FY14).
- At the time, Air Niugini responded to the exit of Airlines PNG by increasing its own capacity between Brisbane and Port Moresby by 10 per cent, supported by a codeshare arrangement with Qantas.
- Virgin Australia currently operates a six per week B737-800 service on the Brisbane route fitted with 176 seats.
- Airlines PNG also operated services on Cairns-Port Moresby with Dash-8 aircraft with operations on this route ceasing from December 2013.
- Air Niugini responded to the exit of Airlines PNG by increasing its own capacity on the Cairns route by 17 per cent.

- From 30 October 2016, Qantas will operate a daily service between Brisbane and Port Moresby using B737-800 aircraft fitted with 174 seats. As a result of this decision, Qantas will withdraw its current services between Cairns and Port Moresby from this date. Overall, Qantas will operate approximately 37% more own-operated passenger capacity in the Australia-Papua New Guinea market. The proposed code share will enable Qantas to maintain a presence on the Cairns route and importantly offer customers additional options and fares when flying between Australia and Papua New Guinea.
- Air Niugini recently announced that from 30 October 2016, it would increase services between Sydney and Port Moresby from two to three flights per week using B737-800 aircraft, operate a daily service between Port Moresby and Brisbane with wide body B767 aircraft and operate at least two daily flights between Port Moresby and Cairns using Fokker F70/F100 aircraft. Air Niugini also proposes to code share on Qantas' daily B737-800 daily service between Brisbane and Port Moresby from 30 October 2016.
- The independent capacity changes made by Qantas and Air Niugini will result in a 2 per cent increase in Australia-Papua New Guinea market capacity in FY17 and, once in full effect will see market capacity reduce 2 per cent in FY18. In FY18, capacity on the Cairns route will increase 16 per cent and between Sydney and Port Moresby capacity will increase 44 per cent with the commencement of additional Air Niugini services made possible only through the proposed freesale codeshare partnership with Qantas. Air Niugini's changes on the Brisbane route to retain a daily wide body operation will see market capacity decline 11 per cent whilst maintaining crucial freight capacity that narrowbody passenger aircraft are unable to carry.
- Qantas and Air Niugini independently price and sell services on the Papua New Guinea route with each operating separate yield management systems, creating a genuinely competitive dynamic. The carriers each offer separate fare structures and rules resulting in varied fare levels and fare conditions, giving passengers more choice and flexibility. Under the freesale code share arrangements, the marketing carrier is incentivised to price competitively with the operating carrier and vice versa.
- In addition, the presence of other competitors, coupled with the potential for new entry, continues to act as a real competitive constraint on both Qantas and Air Niugini. A recent Report by the Centre for Pacific Aviation (CAPA) on PNG Air (formerly Airlines PNG) resuming international services stated that the airline would *"reconsider Port Moresby-Cairns as well as evaluating other regional international routes that are within the range of the ATR-72-600*". The report also suggested that "*Cairns could become more attractive since Qantas (in Jul-2016) unveiled plans to drop Cairns-Port Moresby and instead launch Brisbane-Port Moresby from the end of Oct-2016. This will result in new competition for Virgin Australia and Air Niugini on Brisbane-Port Moresby but result in an approximately 50% capacity reduction on Cairns-Port Moresby*".[1]
- The ACCC in its recent draft determination proposing to re-authorise Virgin Australia and Singapore Airlines to continue their existing airline alliance, accepted that code sharing arrangements can result in material public benefits through 'the promotion of competition in international air passenger transport services markets' and in offering a network proposition which is greater than either airline could have offered alone, code share partners are likely to attract passengers who otherwise may not have flown with either carrier and this is likely to trigger a competitive response from competing airlines.[2]

[1] http://centreforaviation.com/analysis/papua-new-guineas-png-air-fleet-renewal-to-drive-domestic-growth-and-international-resumption-298323

[2] Draft Determination Application for revocation of A91267 & A91268 and the substitution of authorisations A91539 & A91540 lodged by Virgin Australia and Singapore Airlines in respect of an airline alliance (Authorisation numbers: A91539 & A91540) 25 August 2016, p.1 - www.accc.gov.au.

- The code sharing arrangements ensure that Air Niugini remains an operator and competitor in the market, in turn delivering public benefits. In the absence of the proposed code sharing arrangements, Air Niugini's operations on the Papua New Guinea route will potentially be adversely affected:
    - In reference to increasing services on the Cairns route from 11 to 14 weekly frequencies, Air Niugini has indicated to the ICCC that *"it would need to carefully review the ongoing sustainability of these services in the absence of ongoing contributions towards operating costs of those services, which would otherwise be earned from Qantas as marketing carrier on this route"*[3].
    - Similarly, on the Sydney route, Air Niugini has stated that "*there is also a material risk that, without the contribution of revenue from Qantas seat sales towards operating costs of Air Niugini's services, Air Niugini will need to withdraw from the route as there is insufficient demand on the Sydney route to maintain an independent operation, leaving customers no option to fly directly between Port Moresby and Sydney"*[4].
    - On the Brisbane route, Air Niugini has stated it will not be able to sustain its current 13 per week operation, and in the absence of the code share its ability to operate effectively between Port Moresby and Brisbane will be further hampered, risking its wide body operations which provide critical freight capability.[5] These impacts are discussed further under the 'Trade Benefits' section.
- Absent the code share arrangements, Air Niugini will also be the only direct selling carrier on the Sydney and Cairns routes and will be in a position to make frequency, capacity and pricing adjustments without the competitive tension of the codeshare.

5.1 (b) Tourism benefits

- Qantas and Air Niugini have extensive domestic networks within their respective home markets which are currently accessed by both carriers via interline arrangements. Under the proposed code share arrangements, for the first time Air Niugini will code share on domestic services within Australia operated by Qantas between Brisbane and Melbourne / Perth, and Sydney and Melbourne / Perth. This will provide more 'destination Australia' travel options and itineraries for Air Niugini to market and promote under its code, particularly from point of sale Papua New Guinea.
- Constraints in the air services arrangements between Australia and Papua New Guinea limit the ability to effectively compete in beyond markets and international travel to/from Papua New Guinea is predominately driven by point-to-point demand. Notwithstanding this, Qantas provides connectivity beyond Australia to other points in the Pacific, New Zealand, Asia, North and South America, Europe and South Africa, and Air Niugini operates services to 11 international destinations from Port Moresby that code share passengers are able to connect to.

5.1 (c) Consumer Benefits

- The proposed code share arrangements include additional code share routes for Qantas marketed services on Air Niugini operated services between Port Moresby and Cairns,

[3] Air Niugini '*Application for Authorisation' [Port Moresby and Cairns]*', p.6 – http://www.iccc.gov.pg; Air Niugini Submission on Public Benefit to the International Air Services Commission, 9 September 2016, p.5.
[4] Air Niugini '*Request for Variation of Code Share Arrangements in Determination A2015/18 between Air Niugini and Qantas on Routes between Port Moresby and Brisbane/Sydney*', p.5 – http://www.iccc.gov.pg.
[5] Ibid. p.5.

and Air Niugini marketed services on Qantas operated services between Brisbane and Port Moresby. For the first time, Air Niugini will code share on domestic services within Australia as outlined above.

- The proposed code share arrangements maximise the degree of choice in the market as this outcome would unlikely be matched if the code share was not in effect, potentially leading to fewer competitors, fewer frequencies or smaller aircraft operating, or less destinations being served and/or less choice of fares. Different aircraft types operate between Australia and Papua New Guinea, optimising route economics and catering for passengers who have preferences for particular aircraft types.
- An environment driving innovative product differentiation is also supported by the code share arrangements, as the two carriers each operate their own aircraft between the two countries and offer different "non-flying" products, such as frequent flyer programs and benefits, full service product offerings, and different booking and distribution systems.
- Code sharing arrangements have supported the ongoing viability of Air Niugini and, as such, are of vital importance to the PNG economy. Air Niugini has stated that *"in order to sustain wide body operations from Papua New Guinea to Asia, Air Niugini must achieve sufficient utilisation of its aircraft across the whole of its international network. Services between Papua New Guinea and Australia account for a significant proportion of Air Niugini's wide body aircraft operations, such that the viability of continued wide body aircraft operations by Air Niugini to Asian destinations depends upon achieving viable passenger loads on its Australian services"*[6].

5.1 (d) Trade Benefits

- Qantas and Air Niugini have arrangements in place in relation to bellyhold freight whereby Qantas purchases belly hold cargo space on Air Niugini's B767 services between Port Moresby and Brisbane, and then sells this cargo space on its own air waybills under the Air Niugini (PX) code.
- These arrangements have facilitated international trade between Australia and Papua New Guinea and supported regular frequency of services between the two countries. The efficiencies of combined passenger/cargo services are evidenced through more competitive cargo rates for consumers than dedicated cargo providers. Whilst having specific freight uplift capability, dedicated cargo services generally do not operate with as regular frequency as combined passenger/cargo services.
- The operation of regular B767 services is vital to the carriage of commercial volumes of palletised and containerised freight, given such freight uplift capability both in terms of type and volume is not available on narrow body services. Wide body B767 aircraft can carry up to 24 tonnes of freight on services between Brisbane and Port Moresby, whereas a B737 aircraft is typically limited to approximately 1.5 to 2 tonnes of loose freight articles (depending on passenger loads and aircraft configuration). While there are various operators on the route offering dedicated cargo services, including Pacific Air Express' B737-300F twice weekly dedicated freighter services between Brisbane and Port Moresby, Air Niugini is the only carrier (passenger or all cargo) to operate wide body aircraft and the frequency of its services are vital for the regular export of personal effects, fresh produce, time definite express products, pharmaceuticals, mining equipment, aviation parts and machinery from Australia to Papua New Guinea.
- The passenger code sharing arrangements have supported Air Niugini's wide body operations on the Brisbane route. In the absence of the code share, Air Niugini in its

[6] Air Niugini '*Request for Variation of Code Share Arrangements in Determination A2015/18 between Air Niugini and Qantas on Routes between Port Moresby and Brisbane/Sydney*', p.5 – http://www.iccc.gov.pg.

recent application for code share authorisation to the ICCC considers that "*in the medium to long term Air Niugini would be forced to substantially withdraw from operating wide body aircraft. Among other consequences, Papua New Guinea would lose a significant source of commercial air freight services, resulting in substantial negative consequences for Papua New Guinean businesses and consumers which rely on these services, including higher freight prices (as dedicated freighters typically charge higher rates than freight carried on wide body passenger services).*"[7] Air Niugini's submission of 9 September 2016 to the Commission echoes these concerns.

<u>5.1 (e) Industry Structure</u>

- The proposed code share will impact positively on the Australian aviation industry through increased competition, efficiencies and lower operating costs, providing a wider range of services and choice for consumers.
- Air Niugini's applications to the ICCC and to the Commission demonstrate the positive way in which code sharing arrangements with Qantas have supported its presence and growth in the Australia-Papua New Guinea market and contributed to maintaining wide body aircraft operations. As a State owned carrier, this benefits the Papua New Guinea economy which in turn provides indirect benefits to aviation.
- The continued presence and growth of Qantas and Air Niugini on the Papua New Guinea route under code sharing arrangements has encouraged competition as evidenced by the entry of new carriers. Pacific Blue (now Virgin Australia) entered the market in 2005 when Qantas and Air Niugini were the only competitors on the route and it continues to operate as an active competitor to Qantas and Air Niugini. There remains sufficient bilateral capacity for airlines of Australia or Papua New Guinea to either enter the market or expand existing services.

Qantas is only in a position to code share on the Papua New Guinea route with Air Niugini on a freesale basis and the current code share arrangements will not apply from 30 October 2016. Absent the code share arrangements, it is unlikely that the significant competition, consumer, tourism, trade and industry benefits could be provided.

[7] Air Niugini '*Request for Variation of Code Share Arrangements in Determination A2015/18 between Air Niugini and Qantas on Routes between Port Moresby and Brisbane/Sydney*', p.5 – http://www.iccc.gov.pg.