Australian Government

International Air Services Commission

DRAFT DECISIONS

Draft Decisions:	**[2018] IASC 210d and [2018] IASC 211d**
Variation of:	**[2014] IASC 105 and [2016] IASC 110**
The route:	**Papua New Guinea (PNG)**
The applicant	**Qantas Airways Limited (ACN 009 661 901) (Qantas)**
Public Register File:	**IASC/APP/201814 and 201818**

The Commission, after conducting a review, proposes to make a decision under section 25 of the *International Air Services Commission Act 1992* not to vary Determinations [2014] IASC 105 and [2016] IASC 110, in a manner requested by Qantas.

Summary:

Qantas applied to the Commission to vary Determinations [2014] IASC 105 and [2016] IASC 110 (as varied) to enable Qantas to: (a) continue using its capacity allocation on the PNG route to provide code share services, on a free-sale basis, with Air Niugini on the Brisbane-Port Moresby and Sydney-Port Moresby sectors from 1 July 2018 until the expiry of the determinations; and (b) code share on a free-sale basis, as marketing carrier, on services operated by Air Niugini on the Cairns-Port Moresby and Townsville-Port Moresby sectors for the duration of the determinations.

In this review, the Commission considered aviation data from November 2016 on each of the city pairs and on the Australia-PNG route overall. During this time, Qantas has amended its schedule on the PNG route and entered into free-sale code share arrangements on the Brisbane-Port Moresby and Sydney-Port Moresby sectors with Air Niugini. The data obtained from the Bureau of Infrastructure, Transport and Regional Economics show that over the last 12 months traffic between Australia and Port Moresby has remained quite static, but that load shifted between the gateways. With the move of Qantas services to Brisbane, the market from Cairns declined, while traffic originating in or connecting through Brisbane increased.

The Commission, in 2016, was sufficiently concerned by the potential impact from the accompanying shift from block-space to free-sale code share between Qantas and Air Niugini that the current review was included as a condition of a code share approval until 30 June 2018 for the Brisbane-Port Moresby and Sydney-Port Moresby sectors. The Commission considered that an increased market share for Qantas was the likely outcome of its change of schedule and city pairs served.

Qantas and Air Niugini operate over 81% of the capacity on the PNG route. The impact of the combination of the schedule change and code share approval has been a marked shift of traffic towards Qantas, with its number of passengers carried growing in 2017 by

39%. With static market demand, the increase in Qantas' load came from the other carriers on the route, predominantly from Virgin Australia.

Advice to the Commission from the ACCC repeats concerns that a change from block-space to free-sale code share shifts commercial risk from the marketing to the operating carrier. Under free-sale code share there is no competitive tension to stimulate price competition between the code share partners. Price sampling by the Commission and analysis of confidential data of the route yields provided by Qantas reflect this lack of price competition. Public submissions have previously urged the Commission to approve the code share with the expectation that price competition between the partners would result, but this competitive behaviour was not observed.

Previous decisions by the Commissions anticipated that if Qantas re-entered the Brisbane sector, it was likely to emerge as the strongest competitor and capture a substantial portion of the passenger traffic. The available data reflect this outcome.

The Commission's view is that to approve Qantas' proposed free-sale code share with Air Niugini would reduce competition by increasing barriers to entry on the city pairs served only by Air Niugini (Cairns-Port Moresby, Sydney-Port Moresby, Townsville-Port Moresby) and risk the withdrawal of Virgin Australia on the Brisbane-Port Moresby sector where Qantas and Air Niugini offer parallel services. This being the case, the Commission considers that it would not be of benefit to the public to approve Qantas' application.

The Commission notes that Air Niugini has expanded its network to include services from Townsville alongside its flights from Cairns to Port Moresby in the absence of code share operations. The Commission also notes that the absence of a code share is not an impediment to other forms of commercial relationships between Qantas and Air Niugini, including loyalty programs, bilateral pricing, and the purchase of freight capacity on Air Niugini's B767 aircraft.

The Commission proposes not to approve Qantas' application for authorisation:

(a) to extend the free-sale code share arrangements between Qantas and Air Niugini on the Brisbane-Port Moresby and Sydney-Port Moresby sectors from 1 July 2018; or

(b) of the free-sale code share arrangements between Qantas and Air Niugini on the Cairns-Port Moresby and Townsville-Port Moresby sectors.

1 The application and submissions

1.1 On 16 February 2018, Qantas applied to the Commission for a variation of Determinations [2014] IASC 105 and [2016] IASC 110 (as varied), to permit the utilisation of capacity on the PNG route for code share services with Air Niugini for the duration of the determinations.

1.2 In its application, Qantas stated that it wishes to continue to place its code on Air Niugini services between Sydney and Port Moresby and between Brisbane and Port Moresby; and Air Niugini to place its code on Qantas services between Brisbane and Port Moresby. Qantas also plans to add its code to Air Niugini services between Port Moresby and Cairns and Port Moresby and Townsville.

1.3 Determination [2014] IASC 105 allocates to Qantas 888 seats per week (valid until 23 March 2020) while [2016] IASC 110 allocates 1,000 seats per week (valid until 30 June 2022). This gives Qantas a total capacity allocation of 1,888 seats per week in each direction on the PNG route.

1.4 On 16 November 2016, the Commission varied these two determinations to authorise code sharing, under a free-sale arrangement, between Qantas and Air Niugini on the Brisbane-Port Moresby and Sydney-Port Moresby sectors. The authorisation is valid until 30 June 2018. (There is currently no code share authorised on the Cairns-Port Moresby and Townsville-Port Moresby sectors).

1.5 On 16 February 2018, the Commission published a notice, in accordance with section 22 of the *International Air Services Commission Act 1992* (the Act), inviting submissions about the application.

1.6 Between 16 February and 2 March 2018 (the closing date for making a submission), the Commission received 5 submissions supporting, either in part or in full, the proposed code share between Qantas and Air Niugini. The submissions supporting the proposed code share arrangements were received from a member of the public (Mr Michael Murphy); Air Niugini Limited; Townsville Airport; Townsville Enterprise; and Townsville City Council. Their submissions are available on the Commission's website <www.iasc.gov.au>.

1.7 Virgin Australia made a submission opposing Qantas' application. The Commission accorded Qantas the opportunity to respond to Virgin Australia's submission and Qantas provided its response on 15 March 2018.

1.8 The Commission consulted the Australian Competition and Consumer Commission (ACCC) which provided its submission on 14 March 2018. The ACCC reiterated its publicly stated view that from a competition perspective, a hard-block code share is generally preferable to a free-sale code share since it moves risk to the code share partner and encourages a greater degree of rivalry between the airlines.[1] Qantas responded to the ACCC submission on 21 March 2018.

1.9 A summary of the Qantas application and submissions is at **Attachment A**.

1.10 All non-confidential material supplied by Qantas and the submitters are filed on the Register of Public Documents and made available on the Commission's website. Confidential material supplied by Qantas, Virgin Australia and Air Niugini is filed on the Commission's confidential register.

1.11 The Commission has analysed the PNG market data to assess any changes to the competitive environment and public benefit situation on the route since its 2016 review. The Commission sourced its aviation data from the Bureau of Infrastructure, Transport and Regional Economics (BITRE); commercial-in-confidence material provided by Qantas, Virgin Australia and Air Niugini; and a sampling of airfare prices available on the airlines' websites and online travel agency sites.

[1] ACCC submission dated 14 March 2018 which refers to its 2016 submission dated 6 October 2016

2 Relevant provisions in the bilateral air services arrangements

2.1 Under the terms of the bilateral air services arrangements between Australia and PNG, any Australian designated airline is entitled to perform any of their agreed services through code sharing, blocked space and/or any other cooperative service arrangements with any designated airlines of either Australia or PNG, over the whole or any part of the specified routes in the Route Schedule.

2.2 All code share arrangements must be operated in compliance with route, traffic rights and capacity entitlements applicable to each country. Capacity that is marketed and sold by a code share partner under its own designator counts as the exercise of Australian capacity entitlements under the air services arrangements.

3 Requirements under the Act and the Minister's Policy Statement

3.1 Qantas' application seeks to vary two determinations to include a condition of a kind referred to in paragraph 15(2)(e) of the Act. In view of this, the application is a transfer application as so defined in subsection 4(1) of the Act and has been assessed in accordance with section 25.

3.2 Section 25 effectively provides that the Commission must make a decision varying the determination in a way that gives effect to the variation requested unless the Commission is satisfied that the proposed variation would not be of benefit to the public. In order for the Commission to make a decision varying the determinations 'in a way that gives effect to the variation requested', the Commission must be satisfied, after conducting a review of the application, that the proposed variation, as a whole, would be of benefit to the public.

3.3 Under section 26 of the Act, in assessing the benefit to the public of a variation of an allocation of capacity, the Commission is required to apply the criteria set out in any policy statement issued by the Minister under section 11.

3.4 On 20 March 2018, the Hon. Michael McCormack MP, Deputy Prime Minister and Minister for Infrastructure and Transport, issued the International Air Services Commission Policy Statement 2018 (2018 Policy Statement), which came into effect from 28 March 2018. Under part 6 of the 2018 Policy Statement, in deciding an application that was received before the commencement of the 2018 Policy Statement, the Commission is required to apply the International Air Services Commission Policy Statement No. 5 issued in 2004.

3.5 As the current application from Qantas was received before the commencement of the 2018 Policy Statement, the Commission is required to apply the criteria set out in the 2004 Policy Statement (hereinafter referred to as the 'Policy Statement').

3.6 Under the Policy Statement, there are two sets of criteria for assessing public benefit. The first one is provided in paragraph 4 of the Policy Statement which provides that the use of entitlements by Australian carriers under a bilateral arrangement is of benefit to the public unless such carriers are not reasonably capable of obtaining the necessary approvals to operate on the route and of implementing their proposals. The second set of criteria for assessing public benefit is set out in paragraph 5. The paragraph

5 criteria comprise competition, tourism, consumer, trade and aviation industry benefits and any other criteria that the Commission may consider relevant. The Policy Statement provides that the Commission is not obliged to apply all of the listed criteria in paragraph 5, and in applying the criteria it should take as the pre-eminent consideration the competition benefits of the application.

3.7 Paragraph 6.4 of the Policy Statement provides that in circumstances set out in paragraph 3.6, whether or not submissions are received, the Commission may apply the additional criteria in paragraph 5 of the Policy Statement.

3.8 Under paragraph 3.6, where capacity that can be used for code share operations is available under air services arrangements, including where foreign airlines have rights to code share on services operated by Australian carriers, the Commission would generally be expected to authorise applications for use of capacity to code share. However, if the Commission has serious concerns that a code share application (or other joint service proposal) may not be of benefit to the public, it may subject the application to more detailed assessment using the additional criteria set out in paragraph 5 (whether the application is contested or not). Before doing so, the Commission is required to consult with the ACCC, which the Commission has done in this case.

3.9 On previous occasions when the Commission considered applications by Qantas to code share with Air Niugini, it has had serious concerns about the impact of the code share on competition on the PNG route and had assessed the applications under both paragraphs 4 and 5 of the Policy Statement. In relation to the current application, the Commission has again decided to assess the application against the criteria set out in both paragraphs 4 and 5. In light of this, as required under paragraph 3.6, the Commission consulted the ACCC.

4 Development of code sharing on the PNG route and previous Commission decisions

4.1 Qantas entered into code sharing with Air Niugini on the Cairns-Port Moresby sector in 1987. The code share enabled Qantas to sell seats on Air Niugini-operated services. In 1992, the Commission authorised Qantas to continue the code sharing, as marketing carrier, on Air Niugini's services between Cairns and Port Moresby. Qantas was not operating parallel services on this sector. At that time, Qantas and Air Niugini were operating parallel services between Brisbane and Port Moresby, but there was no code sharing on these services.

4.2 In March 2002, the PNG government invited Qantas to consider options for ensuring the viability of Air Niugini's operations following financial losses. This led to changes in the code share arrangements between Qantas and Air Niugini. In August 2002, upon Qantas' request, the Commission reduced its capacity allocation (from 1,550 to 1,000 seats per week) on the PNG route and authorised expanded code share arrangements to permit Qantas to code share on all of Air Niugini's services between Australia and PNG. Under the expanded code share, Qantas ceased operating services in its own right on the PNG route but offered services as a marketing carrier of Air Niugini-operated flights.

4.3 In its 2002 decision, the Commission stated 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. However, an important consideration for the Commission at that time was to ensure the continuation of Air Niugini's services, the loss of which would likely lead to a far greater loss of public benefit than under the code share arrangement. With the approval of the code share, Air Niugini introduced direct services between Sydney and Port Moresby in 2002 and nearly doubled the number of seats and frequencies it operated on the Brisbane-Port Moresby sector.[2]

4.4 In 2005, Airlines PNG (now PNG Air) entered the market, offering daily services between Cairns and Port Moresby and three weekly services between Brisbane and Port Moresby. The entry of Airlines PNG initially saw a decline in the market share of both Air Niugini and Qantas. In 2008, Airlines PNG entered into a hard-block code share arrangement with Virgin Australia on the Brisbane-Port Moresby sector. Once Virgin Australia commenced Brisbane-Port Moresby operations in November 2008, Airlines PNG ceased operating its own services on this sector but retained its daily Dash-8 services between Cairns and Port Moresby. The latter sector did not involve code sharing.[3] Airlines PNG ceased all operations on the Australia-PNG route in December 2013.

4.5 In 2007, the Commission re-authorised the code share between Qantas and Air Niugini under a hard-block arrangement with an option for Qantas to purchase a further soft-block of seats on each flight. The authorisation for the hard-block code share was further re-authorised in 2009, valid until 30 June 2012.

4.6 In the November 2007 decision, the Commission was critical of the soft-block element of the code share arrangements which allowed Qantas to shift commercial risk to Air Niugini through the option of buying or not buying extra seats, depending on how likely the hard-block seats were 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 commercial pressure to discount significantly. The Commission said that the arrangements would be more competitive if the Qantas' hard-block was for a larger number of seats and was more uniform across flights, rather than leaving some services with smaller or no soft-block components.

4.7 In its November 2007 decision, the Commission said that if the approval were not continued, Qantas would almost certainly re-enter the Sydney and Brisbane sectors. It considered that if Qantas re-entered the market in its own right, there could be higher public benefits in the short term as it would be likely that air fares would fall 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 Air Niugini's wide-bodied B767 services on the route, with the capacity to move large freight items in containers and on pallets.[4]

4.8 In November 2008, Virgin Australia (under the Pacific Blue brand) commenced services to PNG with the operation of 4 weekly B737 services between Brisbane and Port Moresby. As indicated above, Virgin Australia's services were supplemented by a hard-

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[2] [2002] IASC 219
[3] [2008] IASC 218
[4] [2007] IASC 213

block code share arrangement with Airlines PNG. Virgin Australia then added a fifth service from April 2012, followed by a sixth service from July 2014.[5]

4.9 In its 2009 decision, the Commission noted the positive effect of the entry of Pacific Blue (Virgin Australia) in 2008, because the additional services delivered an increased range of fares and product choice. The 2009 decision reiterated comments about the risks noted in the 2007 decision about Qantas re-entering the market in its own right if the code share were not authorised As in the 2007 decision, the Commission emphasised the importance of keeping Air Niugini in the market in order to prevent the outcome of Qantas becoming a monopoly provider, thus lessening public benefit. Likewise, the Commission reiterated its criticism of the soft-block component of the code share, stating that it 'is disappointed that there is little evidence of any action by Qantas that addressed these concerns'.[6]

4.10 In March 2010, Qantas applied for an additional allocation of 888 seats (which the Commission granted) to enable the airline to operate its own services between Cairns and Port Moresby from 1 July 2010. Qantas' application did not include a request to code share with Air Niugini on these services.[7] From 1 July 2010, Qantas commenced its own services between Cairns and Port Moresby in competition with services operated by Air Niugini and Airlines PNG on this sector.

4.11 In June 2012, the Commission authorised the amended code share arrangements between Qantas and Air Niugini. The new arrangement was a hard-block code share with the soft-block component removed. Qantas was no longer able to return unsold seats, and the code share was only on the Brisbane-Port Moresby and Sydney-Port Moresby sectors.[8] Qantas did not apply for code share authorisation with Air Niugini on the Cairns-Port Moresby sector. At that time, Qantas and Air Niugini were providing parallel services on this sector.

4.12 On 27 July 2016, Qantas announced changes to its PNG operations, stating that it would shift its services from Cairns to Brisbane from 30 October 2016. On 25 August 2016, Qantas applied to the Commission to authorise its code share with Air Niugini on the Brisbane-Port Moresby, Cairns-Port Moresby and Sydney-Port Moresby sectors, but this time under a free-sale arrangement. Qantas' application requested that the code share authorisation apply to all of its capacity allocation of 1,888 seats.

4.13 In its November 2016 decisions, the Commission expressed concern about the shift from hard-block to free-sale arrangements, stating that it moved the commercial risk on the flights from Qantas to Air Niugini, and would likely lessen Air Niugini's competitive position. However, the Commission considered that the potential lessening of competition on the Brisbane-Port Moresby and Sydney-Port Moresby sectors may be offset by the introduction by Qantas of its own-operated services on the Brisbane-Port Moresby sector. In relation to the Sydney-Port Moresby sector, the Commission concluded that while Air Niugini is the only carrier servicing the sector, the Sydney services faced competition from

[5] Virgin Australia submission to the IASC, 2 March 2018
[6] [2009] IASC 216
[7] [2010] IASC 101
[8] [2012] IASC 215

connecting services via Brisbane operated by all three airlines (Air Niugini, Qantas and Virgin Australia). [9]

4.14 Moreover, in 2016, the Commission concluded that in view of the new arrangements being entered into at that time (with Qantas returning to the Brisbane sector, abandoning the hard-block code share and proposing to enter into a reciprocal free-sale code share with Air Niugini on parallel operated services), it was difficult to forecast the likely outcomes with and without the code share. In relation to the Cairns-Port Moresby sector, the Commission considered that approving the code share would entrench the position of Air Niugini as the sole operator on the sector. Qantas would be unlikely to provide price competition, and the code share would place a higher barrier for new entrants looking to operate this sector.

4.15 On 16 November 2016, the Commission authorised the free-sale code share between Qantas and Air Niugini on the Brisbane-Port Moresby and Sydney-Port Moresby sectors only until 30 June 2018, and rejected the code share on the Cairns-Port Moresby sector. In approving the free-sale code share arrangement for Brisbane and Sydney, the Commission noted that this would provide the opportunity to see how the new arrangements would work in practice on these city pairs.

4.16 In its current application, Qantas again has applied for code share authorisation on all city pairs including where Qantas and Air Niugini are operating parallel services. As the free-sale code share has been operating for over a year, the Commission considers that it is now able to assess the impact of the free-sale code share.

5 Current services and code share arrangements

5.1 Currently, Air Niugini is the largest operator on the route, operating 21 weekly services, broken down as follows:

- 7 B767 services per week between Brisbane and Port Moresby. Qantas code shares on a free-sale basis on these services
- 9 F28 services per week between Cairns and Port Moresby. No code sharing
- 3 B737 services per week between Sydney and Port Moresby. No code sharing
- 2 F28 services per week between Townsville and Port Moresby. No code sharing[10].

5.2 Qantas currently operates 7 B737 services per week between Brisbane and Port Moresby[11]. Air Niugini code shares on a free-sale basis on these services[12].

5.3 Up until February 2018, Virgin Australia was operating 6 B737 services per week between Brisbane and Port Moresby. It has since reduced its capacity to 5 B737 services per week.[13] Virgin Australia has no code share partner on these services.

[9] [2016] IASC 220, 221 and 222

[10] Northern Winter 2017-18 International Airlines Timetable Summary

[11] In October 2016, Qantas decided to operate its own aircraft between Brisbane and Port Moresby and withdraw its 12 weekly DHC-800 services between Cairns and Port Moresby.

[12] Northern Winter 2017-18 International Airlines Timetable Summary

[13] Northern Winter 2017-18 International Airlines Timetable Summary; Virgin Australia submission to the IASC, 2 March 2018.

6 Characteristics of the Australia – PNG route

6.1 After 7 years of growth between 2006 and 2013, passenger growth has slowed in recent years. In 2016, passenger traffic decreased by 6% and in 2017, it decreased further by 1% (refer to tables 5 and 6 below).

6.2 Data from BITRE show that in the calendar year ending December 2017, there was a slight increase in the total capacity (seats available) on the Australia-PNG route despite both Air Niugini and Virgin Australia reducing their capacity by 4.85% and 1.74%, respectively. Qantas increased its capacity by 28.29%, which raised the over-all capacity on the PNG route by 1.51% (refer to table 1 below).

Table 1: Seats available[14] (capacity) on own-operated services[15]

Airlines	2013	2014	2015	2016	2017
Air Niugini	355,722	341314	379,322	348,604	331,696 59%
Airlines PNG	6,224	0			
Qantas	90,390	90,946	90,860	95,935	123,084 22%
Virgin Australia	91,520	101,024	110,380	108,436	106,548 19%
Total	544,856	533,284	580,562	552,975	561,328 100%

Source: BITRE, December 2017

6.3 In terms of available capacity offered by airlines by ports, Brisbane has the largest share with 66% (with three carriers operating services in their own right), followed by Cairns with 24%, then Sydney with 8% and Townsville with 2%.[16] For Cairns, Sydney and Townsville, only Air Niugini operates on these sectors, with Qantas offering code share services, as marketing carrier, on the Sydney sector. In addition, on their respective operations between Brisbane and Port Moresby, Qantas and Air Niugini offer parallel code share services on this sector.

[14] Note that 'seats available' is used to calculate 'seat share' in the market in this document.
[15] The BITRE data in Table 1 reflect both inbound and outbound seats available.
[16] BITRE, December 2017. Note that the data on Air Niugini's Townsville operations reflect only nine months of operations (31 March-31 December 2017).

Table 2: Services operated before and after the free-sale code share

Airline and route sector	Northern Summer 2016 services pw	Northern Winter 2016/17 services pw	Notes
Air Niugini Brisbane Cairns Sydney	 8 B767 6 B737 11 F28 2 B737	 7 B767 16 F28 3 B737	On the Cairns sector, Air Niugini increased services to 16 pw from 30 Oct 2016 when Qantas ceased operating. It reduced its Cairns services to 15, then 13 pw in 2017 and to 9 pw from March/April 2018
Qantas Brisbane Cairns	 Nil 12 DHC-800	 7 B737 Nil	
Virgin Australia Brisbane	 6 B737	 6 B737	Virgin Australia reduced its Brisbane services to 5 pw in February 2018

Source: International Airlines Timetable Summary published by the Department of Infrastructure, Regional Development and Cities

Table 3: Total passengers per port (January –December)[17]

	2016			2017		
Port	Inbound	Outbound	Total	Inbound	Outbound	Total
Brisbane	89,957	90,917	180,874	93,889	91,091	184,980 66%
Cairns	45,924	44,091	90,015	35,811	33,106	68,917 24%
Sydney	8,635	8,935	15,570	11,091	11,589	22,680 8%
Townsville	0	0	0	2894	2882	5,776 2%

Source: BITRE, December 2017

6.4 In terms of seat utilisation, Air Niugini improved its over-all load factor on the PNG route by 0.6% points while Virgin Australia’s load factor decreased by 13.4% points. Qantas increased its load factor by 4.3% points. [18]

Table 4: Seat utilisation (load factor)

Airlines	**2013**	**2014**	**2015**	**2016**	**2017**
Air Niugini	58.7%	53.6%	53.4%	53.5%	54.1%
Airlines PNG	53.4%				
Qantas	57.9%	57.6%	51.2%	52.5%	56.8%
Virgin Australia	52.2%	55.2%	53.3%	48.1%	34.7%

Source: BITRE, December 2017

6.5 In relation to passenger traffic share on the PNG route, Air Niugini, has 62.7%, Qantas 24.4% and Virgin Australia 12.9% of the traffic. Air Niugini’s market share

[17] The BITRE data reflect both inbound and outbound seats available.
[18] BITRE, December 2017

decreased in 2017 by 1.8% points. Qantas' position improved by 7% points and Virgin Australia's market share fell by 5.2% points.[19]

Table 5: Market share of passenger traffic (passengers carried on directly connected services between Australia and PNG)

Airlines	2013	2014	2015	2016	2017
Air Niugini	208,732 66.7%	182,777 62.8%	202,693 65.8%	186,416 64.5%	179,538 62.7%
Airlines PNG	3,322 1.1%				
Qantas Airways	52,890 16.9%	52,389 18.0%	46,475 15.1%	50,383 17.4%	69,888 24.4%
Virgin Australia	47,800 15.3%	55,775 19.2%	58,823 19.1%	52,178 18.1%	36,988 12.9%
Total	312,744	290,941	307,991	288,977	286,414

Source: BITRE, December 2017

Table 6: Total passengers carried (percentage increase/decrease from the previous year)

Airlines	2013	2014	2015	2016	2017
Air Niugini	16%	-12%	11%	-8%	-4%
Airline PNG	3%				
Qantas	3%	-1%	-11%	8%	39%
Virgin Australia	-4%	17%	5%	-11%	-29%
Total	10%	-7%	6%	-6%	-1%

Source: BITRE, December 2017

6.6 In previous years, business and employment-related activities were the most cited reasons for travel by Australian residents to PNG. In 2016, most Australian residents visiting PNG did so for business (33.0%) and 32.8% gave employment as their reason for travel. The combination of employment and business categories indicates that business-related travel accounted for some 66% of all travel undertaken by Australian residents in 2016. That year, holiday traffic accounted for only 16.1% of Australians visiting PNG.[20]

6.7 The Qantas application of 16 February 2018 notes that the nature of the market remains consistent, with business and employment travel as the key reasons for outbound journeys. The smaller inbound market remains predominantly split between visiting friends and relatives and holiday travel.

7 The Commission's assessment against the public benefit criteria

Paragraph 4 criteria

7.1 Under paragraph 4 of the Policy Statement, the use of entitlements by Australian carriers under a bilateral arrangement is of benefit to the public unless such carriers are not reasonably capable of obtaining the necessary approvals to operate on the route and of implementing their proposals.

7.2 The Commission notes that Qantas is an established international carrier capable of obtaining the necessary approvals to operate on the route and of implementing its proposals.

[19] Ibid.

[20] [2016] IASC 220,221 and 222 citing BITRE as source of data

Paragraph 5 criteria

7.3 Paragraph 5 provides that in assessing whether an application is of benefit to the public, the following criteria are applicable: competition, tourism, consumer and trade benefits and industry structure, and such other criteria the Commission considers relevant. In accordance with paragraph 5.2 of the Policy Statement the Commission is not obliged to apply all criteria, the Commission will review the application against each criterion in paragraph 5.1 taking the competition benefits of the application as the pre-eminent consideration.

Competition Benefits

7.4 Paragraph 5.1(a) of the Policy 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."

7.5 Qantas applied on 16 February 2018 for the extension and expansion of the current code share arrangements. In its application, Qantas stated that while passenger numbers on the PNG route have continued to fall in recent years, the total capacity operated by Air Niugini since the Commission authorised the code share arrangements in November 2016 has remained relatively stable, with around 3,000 seats per week between PNG and Australia. Qantas also acknowledged that while its market share on the PNG route grew, that of Air Niugini and Virgin Australia had fallen in financial year (FY) 2017 compared to FY 2016.[21]

7.6 The Commission is now tasked to assess whether it would not be of benefit to the public to continue to authorise the free-sale code share arrangements between Qantas and Air Niugini on the Brisbane-Port Moresby and Sydney-Port Moresby sectors and to expand the authorisation to include the Cairns-Port Moresby and Townsville-Port Moresby sectors. The pre-eminent consideration in determining whether a variation would not be of benefit to the public is the effect on competition on the route.

<u>Likely future with or without the code share</u>

7.7 In assessing competition benefits, an approach proposed by the ACCC is for the Commission to evaluate the likely future with and without the code share arrangement.

<u>Future without the code share</u>

7.8 In a future without the code share, air services between Brisbane and Port Moresby would be independently operated and marketed by Air Niugini, Qantas and Virgin Australia, with each airline competing vigorously for passenger traffic. In its submission Air Niugini said that in the absence of a code share on this sector, there will be a 'loss of customer choice and competition as Air Niugini and Qantas will only be able to offer seats to customers on aircraft for which they are the operating carrier'[22]. Qantas, in its application, said that without a code share there 'would be a reduction in the number of services and competitors on the PNG route and the flow on effects including reduced capacity, less flexible scheduling and a more limited range of fares for consumers'[23]. Both Qantas and Air Niugini stated that without a code share, it is doubtful that Air Niugini would be able to maintain a wide-bodied aircraft on these services. Virgin Australia in its submission, however, asserted that the continuation and extension of the code share services, rather than their removal, would lead to the outcomes suggested by Qantas[24].

7.9 Without the code share, it is anticipated that Air Niugini would continue to serve and develop the Far North Queensland[25] market in its own right. Given the current static state of demand in the Australia-PNG market (also noted by the ACCC) and the realignment of connecting traffic since Qantas restructured its schedule in 2016, the Commission considers it unlikely that a competitor would commence Far North Queensland operations in the foreseeable future, unless Air Niugini were to significantly raise its price or reduce services.

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[21] The Commission notes that in its application, Qantas used data from 1 July 2016 to 30 June 2017 rather than the more recent data from November 2016 to November 2017 covering the 12-month period when the free-sale code share arrangements with Air Niugini were in effect. The more recent data were available at the time the Commission asked Qantas whether it intended to apply for an extension of the authorisation to code share.

[22] Air Niugini submission dated 2 March 2018, page 4

[23] Qantas' application dated 16 February 2018, page 5.

[24] Virgin Australia's submission dated 2 March 2018, page 7.

[25] A reference to Far North Queensland (FNQ) in the decision refers to the Cairns-Port Moresby and Townsville-Port Moresby sectors combined.

7.10 In the case of services between Townsville and Port Moresby, the Commission notes that Air Niugini commenced two weekly services on 31 March 2017 without a code share partner. [26] The Commission has considered the submissions from Townsville Airport, Townsville Enterprise and Townsville City Council that support the proposed code share between Air Niugini and Qantas. The Commission notes that, even in the absence of a code share partnership, Air Niugini has undertaken successful development of its operations connecting Far North Queensland with Port Moresby. Air Niugini's commitment to the market is underlined by its announced plans to post a senior member of its team as Air Niugini Sales Manager in Townsville[27].

7.11 In relation to the Sydney-Port Moresby sector, the Commission notes that under a free-sale code share arrangement with Qantas, in 2016 Air Niugini increased its B737 services from 2 to 3 per week. Possible outcomes without the code share include Qantas and Air Niugini operating separately on this sector. In its submission Air Niugini said that without the code share it would need either to reduce its services or withdraw from the sector completely if there was insufficient demand to maintain an independent operation. The Commission considers that without a code share, Qantas may have an incentive to change its strategy for obtaining revenue from its existing code share arrangements on the Sydney-Port Moresby sector because it can no longer offer a direct flight using its code.

Future with the code share

7.12 In a scenario where the current authorisation of the free-sale code share on the Brisbane-Port Moresby sector is renewed, Qantas and Air Niugini will continue to market and sell seats on each other's services. With the change from a hard-block to a free-sale arrangement in 2016, the marketing carrier is no longer under pressure to sell seats in competition with the operating carrier. By operating parallel services and selling seats on each other's services the code share partners are able to improve their offering in terms of frequency and passenger convenience, making it more difficult for competing airlines to enter or remain in the market.

7.13 An important consideration for the Commission is whether renewal of the code share authorisation will have a negative impact on competition on the sector. Currently, Virgin Australia is the only carrier offering competing services to the code share partners. The Commission notes that Virgin Australia's load factor has fallen substantially over the 12 months since the free-sale code share began, in contrast to both Qantas and Air Niugini which maintained or slightly increased their load factors. This suggests that Virgin Australia, or any other carrier, will have difficulty competing on the sector while the code share remains in place. Virgin Australia has already reduced its services from 6 to 5 per week and any further reduction would lessen competition and make it harder for Virgin Australia to attract business travellers, who make up a high proportion of outbound traffic. In a market with high business component, there is a need to operate a higher frequency to achieve sustainable services on this sector.[28]

7.14 In relation to the Cairns, Sydney and Townsville sectors, Qantas would be able to market and sell seats on Air Niugini's services on these sectors. In its submission Air

[26] Information sourced from the Department of Infrastructure, Regional Development and Cities
[27] Tony Raggatt, "Niugini's Moresby run 'OK'", Townsville Bulletin, 23 February 2018
[28] The importance of frequency is noted by both Qantas and Virgin Australia in their submissions.

Niugini stated that with Qantas marketing seats on these sectors, with its marketing and distribution strength, the viability of these sectors will improve which would likely allow an increase in services earlier in the future than might otherwise be possible. Air Niugini also stated the code share with Qantas on these sectors would broaden business and trade opportunities between PNG and Far North Queensland.

7.15 However, under a free-sale code share arrangement the Commission considers it is unlikely that Qantas, as the marketing carrier, would offer more competitive prices than those offered by Air Niugini. The Commission also shares the ACCC's view that a free-sale code share arrangement will make it less likely that Qantas will commence its own services on these sectors, even in the event that Air Niugini raised its prices.

Analysis of the PNG route per city-pair

7.16 Previous Commissions had approved code share arrangements between Qantas and Air Niugini on sectors where the airlines did not operate parallel services and where the code share arrangements were on a hard-block basis. As Qantas' current application involves a future with a free-sale code share, the Commission needs to consider both the viability of competition on the route and barriers to entry for other airlines. This is considered in further detail below.

7.17 In its assessment of the Australia-PNG aviation market, the Commission has assessed both the total route and considered the characteristics of its submarkets. The Australia-PNG market exhibits weak demand, with uplifts from Australia ranging between 140,000 and 152,000 passengers since 2011. 2017 was the second consecutive year with a decline in the total volume of traffic between Australia and PNG. None of the submissions made to the Commission suggested that any carrier expected the market conditions to shift towards sustained growth.

Brisbane-Port Moresby

7.18 Brisbane-Port Moresby is the only sector on which all three carriers (Air Niugini, Qantas and Virgin Australia) operate. Qantas commenced a daily service between Brisbane and Port Moresby on 30 October 2016, and appears to have achieved a slightly stronger load factor than Air Niugini and a substantially higher load factor than Virgin Australia. The code share approval, alongside the parallel services of Qantas and Air Niugini on this sector, is an arrangement that was approved by the Commission in 2016 for a limited period, subject to a review of the impact of this arrangement on competition on the route.

7.19 Virgin Australia claimed in its submission that its commercial performance on the PNG route "deteriorated dramatically in 2017, following the commencement of parallel code share services by Qantas and Air Niugini between Brisbane and Port Moresby".[29]

7.20 The BITRE data show that in 2017 there was a significant decline in passenger numbers for Virgin Australia. Between 2014 and 2016, Virgin Australia's share of total passengers carried on direct flights between Brisbane and Port Moresby was stable at around 18 to 19%. In 2017 Virgin Australia's share decreased to 12.9%.

[29] Virgin Australia's submission dated 2 March 2018, page 3.

7.21 In its response to Virgin Australia's submission, Qantas stated that while "Virgin Australia's submission attributed the deterioration of its performance on the Brisbane sector to the support the code share services are providing to Qantas and Air Niugini…, it is by no means clear that the code share arrangements rather than the entry of Qantas' operated services between Brisbane and Port Moresby or commercial considerations unrelated to the code share arrangements have influenced Virgin Australia's current position".[30]

7.22 The Commission's assessment of the BITRE data shows that the re-entry of Qantas in its own right on the Brisbane-Port Moresby sector, when supplemented by a free-sale code share with Air Niugini, has changed the competition dynamics between the airlines. One indication of this change is the 39.0% passenger number increase for Qantas in 2017 on a 28.29% seat capacity increase (refer to tables 1 and 6). Analysis of the BITRE data by the Commission also identifies that there has been a shift in connecting traffic from Cairns to Brisbane and Sydney (refer to table 3).

7.23 The Commission notes the network and loyalty program strength that Qantas brings to the route for Air Niugini. In its submission, Air Niugini states that in relation to the Brisbane-Port Moresby sector, it is Qantas' support, via its extensive customer network and base, which enables Qantas to sell seats on Air Niugini's Brisbane services which Air Niugini could not sell on its own, that "is critical to Air Niugini's ability to achieve sufficient passenger loads and frequency of services on its Australian routes to make wide body aircraft operations viable"[31]. This supports the Commission's view that the code share is a significant factor in maintaining Air Niugini's services on the Brisbane sector.

7.24 While Qantas' submission asserts that the code share carriers 'create a genuinely competitive dynamic', the Commission found little or no evidence of Qantas attracting market share through price competition on the sector since the introduction of the free-sale code share. Qantas code share fares are, on most occasions, higher than Air Niugini for the same date of travel on the same aircraft (as illustrated below). Fare sampling by the Commission indicates that code share seats offered by the marketing partner are priced higher than those offered by the operating carrier on the same flight. The hopes expressed in public submissions that the code share would lead to price competition between Qantas and Air Niugini have not been met. The Commission believes that the shift from block-space to free-sale code share removed the commercial tension necessary to drive price competition between the code share partners.

Economy	Air Niugini (PX)		Qantas (QF)		Virgin Australia (VA)	
Bris-POM 08-02-2018 (one way)	$339	c/s QF-operated $472	$301	c/s seat PX-operated $545	$297	
Bris-POM (one way) 22-02-2018	$353	c/s seat QF-operated $493	$315	c/s seat PX-operated $580	$311	

[30] Qantas' submission dated 15 March 2018

[31] Air Niugini's submission dated 2 March 2018, page 4.

Business	Air Niugini (PX)		Qantas (QF)		Virgin Australia (VA)	
Bris-POM 25-04-2018 (one way)	$1,769.99	c/s QF-operated (none)	$1,772	c/s seat PX-operated $2,282	$1,530	
Bris-POM (one way) 26-04-2018	$1,519.99	c/s seat QF-operated $2,314.99	$1,772	c/s seat PX-operated $2,282	$1,530.59	

7.25 On the Brisbane-Port Moresby sector, the load factor of both Qantas and Air Niugini increased while that of Virgin Australia decreased by 13.4% in 2017 (refer to table 7).

Table 7: Airline load factor: Brisbane-Port Moresby

Airlines	2016	2017
Air Niugini*	52.8%	54.1%
Qantas**	55.3% (30 Oct-31 Dec only)	56.8%
Virgin Australia***	48.1%	34.7%

*Sourced from data available on BITRE website
**Data supplied by Qantas and sourced from BITRE website
***Virgin Australia supplied data and sourced from BITRE website

Table 8: Seats operated on Brisbane-Port Moresby sector and % capacity share (2017)

Airlines	Seats operated	capacity share
Air Niugini	150,616	40%
Qantas	123,084	32%
Virgin Australia	106,548	28%
Total	380,248	100%

Sourced from data available on BITRE website.

Table 8A: Passengers carried on Brisbane-Port Moresby sector and % market share (2017)

Airlines	passengers carried	market share
Air Niugini	78,104	42%
Qantas	69,888	38%
Virgin Australia	36,988	20%
Total	184,980	100%

Sourced from data available on the BITRE website.

7.26 Qantas and Air Niugini, together, operated 72% of the seats between Brisbane and Port Moresby in the past 12 months ending December 2017, and captured a combined market share of 80% (refer to tables 8 and 8A).

7.27 Airline market share is broadly determined by a mix of frequency share and seat share in any market. For markets with a large proportion of business related travel, frequency advantage is the stronger driver of market share, while in leisure markets price is the stronger driver. This relationship is described in the 'S-curve model'[32]. While this model weakens on routes where low cost carriers are competing, it remains valid on routes where traditional network carriers are the main competitors.

7.28 The Australia-PNG route, and more particularly the Brisbane Port Moresby sector, is an example of a route where frequency share is a dominant driver of market share, and where providing increased frequency through free-sale codeshare offers a competitive

[32] Bingelli, U: Pompeo, L (2006) Does the S curve still exist, IATA Analyst Viewpoint, September 2006

advantage to the code share partners. The code share carriers (Qantas and Air Niugini) have a combined seat capacity share of 72% on the Brisbane-Port Moresby sector. This is an important advantage in a predominantly business market, where frequency and seat availability, more so than price, are critical to selling seats. It is the Commission's view that the code share has allowed Qantas and Air Niugini to take a dominant position in the Brisbane-Port Moresby sector with each carrier marketing 14 frequencies per week against five weekly frequencies by Virgin Australia.

7.29 The Commission notes the extent of the decline in Virgin Australia's load factor by 13.4% points to 34.7% in 2017 (refer to tables 4 and 7) and the reduction of its operations from 6 to 5 per week[33]. If Virgin Australia's position is further weakened by the continuation (and expansion to other routes) of the code share arrangement between Qantas and Air Niugini, the Commission sees a risk that Virgin Australia may exit the sector, leaving only Air Niugini and Qantas operating as partners under a code share arrangement. In the absence of operations by Virgin Australia, there would be a substantial lessening of competition on the sector.

7.30 The Commission has also considered the claim that it was Qantas' re-entry into the Brisbane market that had an adverse impact on the commercial performance of its competitors. Previous Commissions had anticipated that if Qantas re-entered the Brisbane market it would likely emerge as the strongest competitor to the detriment of other carriers on the sector. Qantas' entry onto the Brisbane sector has resulted in a decline in passenger traffic for both Virgin Australia and Air Niugini. However, the significant fall in Virgin Australia's load factor, at the same time that Air Niugini and Qantas have been able to improve on their previous load factors, suggests that the free-sale code share has benefited Qantas and Air Niugini at the expense of Virgin Australia. This being the case, the Commission is now of the view that the free-sale code share arrangements would not be of benefit to the public given the possible adverse implications for competition on the sector.

7.31 The Commission concludes that the dominance of Qantas and Air Niugini on the Brisbane-Port Moresby sector is a result of the code share, and that this dominance is reflected in the relative changes to the load factors of Air Niugini and Virgin Australia after Qantas commenced operations on this sector. In 2017, the load factors for Qantas and Air Niugini increased while Virgin Australia's fell. With the implementation of the free-sale code share, Air Niugini was able to reduce its operated capacity while retaining its frequency share in the market[34]. Air Niugini's load factor rose by 1.3% points while Virgin Australia's fell by 13.4% points. There is no obvious alternative explanation for such a profound difference in the competitive impact of Qantas' entry on the performance of Air Niugini and Virgin Australia on the Brisbane-Port Moresby sector. While the differentiated offering of a wide-bodied aircraft might explain some of Air Niugini's stronger outcome, the Commission is reasonably satisfied that a significant part of the difference is explained by the impact of the code share, making it harder for Virgin Australia to compete effectively.

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[33] Virgin Australia submission, 2 March 2018

[34] Prior to the free-sale code share on the Brisbane sector, Air Niugini was operating 14 weekly services. When the code share was authorised in November 2016, Air Niugini reduced its own-operated weekly services to 7 and with the addition of the 7 weekly services operated by Qantas, Air Niugini is able to market 14 services per week.

Far North Queensland: Cairns and Townsville

7.32 The Far North Queensland (FNQ) market has been served exclusively by Air Niugini jet services since Qantas withdrew its 12 DHC-8 weekly services between Cairns and Port Moresby in October 2016. [35] Air Niugini has restructured its operations on the sector, increasing its services to 16 weekly frequencies when Qantas ceased operating on this sector. However, as Air Niugini stated in its submission, Cairns remains a difficult market due to declining passenger numbers, prompting the airline to reduce its services to 15 (then 13) per week in 2017. Air Niugini further stated in its submission that, effective March 2018, it will reduce its Cairns services to 9 per week[36]

7.33 The Commission notes that on 31 March 2017, Air Niugini launched two new weekly services from Townsville. Public information available to the Commission indicates that Air Niugini intends to expand the promotion of its Townsville services with the appointment of a locally based sales manager.

7.34 The Commission notes that, following the shift of Qantas services from the Cairns-Port Moresby to the Brisbane-Port Moresby sector, there was a reduction in traffic from Cairns to Port Moresby of approximately 10,000 passengers per annum. Air Niugini, the remaining operator on the city pair, has tailored its capacity to match remaining demand. The Commission also notes that the total volume of traffic between Australia and PNG is quite static. BITRE data reflect that the market shift following the Qantas change in operations, and the introduction of the code share, was split between the Brisbane-Port Moresby sector and the Sydney-Port Moresby sector. Air Niugini responded to the new code shared structure by reducing its operated capacity on the Brisbane-Port Moresby sector as Qantas entered, and increasing its frequency on the Sydney-Port Moresby sector from two to three frequencies per week.

7.35 The Commission considers that in relation to the Cairns-Port Moresby and Townsville-Port Moresby sectors, where Air Niugini is the only carrier operating services, if the code share were permitted, this would entrench the position of Air Niugini as sole service provider. Qantas would not be expected to price below the airfares offered by Air Niugini. The code share would result in higher barriers for other entrants to operate on these sectors because the code share makes it more difficult for a new entrant to attract sufficient passengers to make new services viable. The existence of the code share would also reduce the incentive for Qantas to enter the route in its own right.

7.36 Furthermore, from the Commission's perspective, Air Niugini has demonstrated its capacity to develop the FNQ market without the Qantas code share, and remains able to cooperate with Qantas through frequent flyer recognition, bilateral pricing, and domestic Australian code shares. BITRE data reflect a rapid establishment of the Townsville originating flights.

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[35] Department of Infrastructure, Regional Development and Cities, Northern Winter 2015-16 International Airlines Timetable Summary

[36] Air Niugini submission, 2 March 2018 and Department of Infrastructure, Regional Development and Cities, International Airlines Timetable Summary (2015-2018)

Sydney-Port Moresby

7.37 Air Niugini increased its Sydney-Port Moresby services from two to three per week during 2017. In its sampling of code share pricing on the Sydney-Port Moresby sector (as illustrated below), the Commission found no evidence of the Qantas code share leading to price competition. In the absence of a code share between Qantas and Air Niugini, the Commission recognises that there may be a shift of Qantas-sold traffic towards Qantas' Brisbane-Port Moresby services (as happened in Cairns), and that a shift in connecting passengers may lead to the Air Niugini operations returning to twice weekly.

	Air Niugini (PX)		Qantas (code share/ PX operated)	
	economy	business	economy	business
Sydney-POM (7 May 2018)	$419.08	$1,709.08	$609-$1,209	$2,284

7.38 The Commission considers that a free-sale code share arrangement between Qantas and Air Niugini on the Sydney sector is unlikely to advance competition on the sector. The code share arrangements deliver revenue to Qantas on the Sydney-Port Moresby sector and so may discourage direct entry by Qantas onto that sector. In addition, because the code share arrangement delivers passengers to Air Niugini from the Qantas network, entry onto the sector by another carrier is made more difficult.

7.39 In light of the foregoing, the Commission considers there would be an adverse impact on competition if the Commission were to authorise Qantas to provide code share services with Air Niugini on the PNG route.

Other Benefits

7.40 In terms of tourism benefits, paragraph 5.1(b) 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)."

7.41 As in previous reviews, the Commission considers that inbound tourism provides a small but positive contribution to the route. The proportion of passengers travelling for purposes of tourism or visiting friends and relatives appears stable at a relatively low rate and is not exhibiting any significant growth.

7.42 The Commission considers that the limited inbound tourism from PNG is not a significant factor in assessing the code share application.

7.43 In terms of consumer benefits, paragraph 5.1(c) 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)."

7.44 During the 2016 review of the code share arrangements, the ACCC proposed in its submission that the Commission investigate whether consumers are likely to benefit from lower fares, greater frequencies or choice of service as a result of the code share. The ACCC also identified the relevance of potential consumer benefits from better online connections for passengers travelling behind and beyond Brisbane and Port Moresby.

7.45 Both Qantas and Air Niugini, in their application and submission respectively, indicated that each airline independently sets its own prices, determines its own fare classes and rules, operates its own yield management systems and sells its products through its own independent sales networks.

7.46 There is little evidence that consumers have benefitted from lower fares as a result of the code share. Qantas' code share business class fares are generally higher than the other two airlines, despite Air Niugini offering a more spacious flat beds product on the B767-300 aircraft serving Brisbane. Virgin Australia's business class fares appear to be the most competitive.

7.47 It appears that higher airfares are not an impediment to Qantas capturing a substantial portion of the market, as evidenced by its increased market share when it started operating services between Brisbane and Port Moresby.

7.48 A member of the public (Mr Michael Murphy) supported the Qantas-Air Niugini code share and expressed concerns that fares on the Cairns-Port Moresby sector have increased by around 20% between mid-2016 and the present time. The Commission notes that Qantas ceased operating its own services between Cairns and Port Moresby in October 2016, leaving Air Niugini as the sole service provider on this sector. The Commission notes that the withdrawal of Qantas' services that previously provided competition to Air Niugini has provided the environment for Air Niugini, as sole operator, to increase its fares. Given the Commission's observation from price sampling that seats sold by the code share partner are frequently more expensive than seats sold by the operating carrier, the Commission considers it unlikely that approving a free-sale code share would lead Qantas and Air Niugini to engage in price competition.

7.49 In its application, Qantas stated that the code share arrangements with Air Niugini would maximise consumers' choices on services to Port Moresby, including access to frequent flyer schemes offered by Qantas and Air Niugini.

7.50 The Commission notes that absent the code share arrangement, Qantas frequent flyer points would still be available for travel on Air Niugini-operated flights. However, there could be a lessening of consumer benefits as the ability to earn status credits and access the Qantas' lounges for tiered passengers would not be available absent the code share. On balance, it is the Commission's considered view that authorising the code share would result in disadvantage to consumers, in the longer term, as the code share would increase barriers to entry by other airlines and reduce the incentive for Qantas to operate on certain city pairs and compete directly against Air Niugini services.

7.51 In the covering letter of its submission to the Commission, Air Niugini stated that the code share with Qantas has assisted in developing Air Niugini's reach into the Australian domestic market, providing greater distribution and travel to other Australian cities, and allowed Air Niugini customers to access seamless travel to and from these centres on one airline ticket.[37] The Commission notes that there is no restriction under the bilateral air services arrangements preventing Qantas and Air Niugini from continuing their code share arrangements on domestic flights operated by the Qantas Group.

7.52 In terms of trade benefits, paragraph 5.1(d) of 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."

7.53 Qantas asserted in its application that the code share contributes to the availability of frequent, low cost and reliable freight movements on the PNG route. Qantas also said that under the code share it obtains a hard-block of freight capacity on B767 services operated by Air Niugini between Brisbane and Port Moresby. Qantas claimed that maintaining the daily Air Niugini B767 operation is vital for the regular export of time-sensitive express products including urgent mining parts, live animals, airmail and general goods that could not be carried on the narrow-body aircraft used by the other carriers. Qantas further stated that lower cargo rates are generally offered for belly-hold space on passenger aircraft than for dedicated freighter operations and that this leads to more competitive cargo rates for consumers.

7.54 The Commission notes that Qantas remains able to purchase cargo space on the Air Niugini B767 operation regardless of the code share arrangements. The Commission notes Air Niugini's assertion of the advantages of its continued operation of the wide-bodied B767 in enabling the airline (and Qantas as its partner) to offer lower cargo rates than dedicated freighter service providers who need to recover the cost of a virtually empty aircraft in one direction. Air Niugini stated that its wide-bodied services promote international trade between Australia and PNG by virtue of the increased availability of lower cost, higher frequency and reliable freight movement for exporters and importers.

7.55 The Commission sought advice from the Department of Infrastructure, Regional Development and Cities (the Department) on the ability of Qantas to continue to purchase a bulk space on Air Niugini's B767 aircraft. The Department advised that under the Australia-PNG air services arrangements, there is no impediment to Qantas entering into a cooperative marketing arrangement with Air Niugini to purchase space on Air Niugini's B767 aircraft, absent a code share arrangement on its passenger capacity allocation.

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[37] Letter of Dominic Kaumu, ML, General Manager Commercial, Air Niugini Limited,dated 2 March 2018

7.56 The Commission acknowledges that absent a code share arrangement with Qantas, there is a risk that Air Niugini may not have access to a sufficient number of passengers to enable it to continue operating the wide-bodied aircraft on the Brisbane sector. However, the Commission is of the view that despite this risk, the lessening of competition brought about by the code share arrangement proposed means that the arrangement does not produce a benefit to the public overall, even if it sustains the operation of wide-bodied aircraft on the sector.

7.57 In relation to Air Niugini's operations from Cairns, Sydney and Townsville to Port Moresby, the Commission reiterates its view that free-sale code share arrangements on these sectors, where Air Niugini is the sole service provider, would increase barriers to entry by other airlines and reduce the incentive for Qantas to operate on these city pairs and compete directly with Air Niugini services.

7.58 In terms of industry structure, paragraph 5.1(e) of the Minister's policy statement provides:

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

7.59 In terms of over-all industry benefit, Qantas claimed that the proposed continuation and expansion of the free-sale code share 'will impact positively on the Australian aviation industry through increased competition and efficiencies, providing a wider range of services and choice for consumers'.[38]

7.60 Virgin Australia claimed that the implementation of the free-sale code share in November 2016, in addition to Qantas' re-entry on the Brisbane-Port Moresby sector, resulted in a dramatic deterioration in Virgin Australia's commercial performance, forcing it to remove its Sunday service. If the proposed continuation of the code share were permitted, Virgin Australia claimed that it would be unlikely that its commercial performance will improve and that it would become challenging for the airline to maintain a meaningful presence on the PNG route over time, which would weaken its position in the Australian aviation industry.

7.61 As in previous reviews on the code share, Air Niugini stated in its submission that the code share (on both the passenger and airfreight component) is crucial to the sustainability of its wide-bodied operations on the route. It said that the code share would enable Air Niugini to operate more efficiently on the PNG route as the code sharing will allow the airline to achieve higher load factors than if it were operating independently, as seats can be sold through Qantas' wider network and marketing channels.

7.62 The Minister's Policy Statement clearly provides that in terms of the impact of the proposed application on the industry, the Commission should assess the extent to which applications will have a positive impact on the Australian aviation industry.

7.63 The Commission considers there is sufficient evidence to show that the free-sale code share arrangement requested by Qantas would provide a competitive advantage to Qantas and Air Niugini and likely disadvantage Virgin Australia, the only other

[38] Qantas' application dated 16 February 2018, page 5

Australian carrier operating passenger services on the route. In the Commission's view, it could have a negative impact on the industry structure, making it less competitive.

8 Conclusion

8.1 Since first approving the code share between Qantas and Air Niugini in 2002, the Commission has had concerns about the possible implications of the code share arrangements for competition on the Australia-PNG route.

8.2 The Commission shares the ACCC's concern that the earlier shift from block-space to free-sale code share between Qantas and Air Niugini had reduced competitive tension on the PNG route.

8.3 There has been a significant change to the competitive environment since the Commission's determination in 2016, with the Qantas re-entry onto the Brisbane-Port Moresby sector and the loss of a competitor for Air Niugini on the Cairns – Port Moresby sector. This is against the background of an Australia-PNG market that exhibits weak demand. 2017 was the second consecutive year that saw a decline in the total volume of traffic between the two countries. None of the submissions made to the Commission suggested that any carrier expected the market conditions to shift towards sustained growth.

8.4 The Commission conducted a review, based on 12 months of traffic and financial data up to 31 December 2017, to assess the impact of the code share arrangements on competition on the route.

8.5 The Commission's finding is that Qantas' proposed free-sale code share arrangement with Air Niugini would reduce competition by increasing barriers to entry on the city pairs served only by Air Niugini (Cairns – Port Moresby, Sydney – Port Moresby, Townsville – Port Moresby) and by risking the withdrawal of Virgin Australia from the Brisbane – Port Moresby sector, where both Qantas and Air Niugini offer parallel services.

8.6 Having conducted a thorough assessment of the application, the Commission is satisfied that if Determinations [2016] IASC 110 and [2014] IASC 105 were varied as requested, it would not be of benefit to the public.

9. Role of the ACCC

9.1 The Commission invited and received a submission from the ACCC and its submission was fully considered in the Commission's deliberations.

9.2 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.

10. Draft Decisions ([2018] IASC 210d, [2018] IASC 211d

10.1 In accordance with section 25 of the Act, the Commission, having conducted a review, proposes to make decisions not to vary Determinations [2016] IASC 110 and [2014] IASC 105, in the manner requested by Qantas.

10.2 The decisions will come into effect on the date these decisions are issued.

Dated: 30 April 2018

IAN DOUGLAS Chairperson	JAN HARRIS Commissioner	KAREN GOSLING Commissioner

Australian Government

International Air Services Commission

Attachment A

QANTAS APPLICATION, 16 FEBRUARY 2018

- Qantas wishes to continue code sharing on Air Niugini's Sydney and Brisbane services and for Air Niugini's to code share on Qantas' Brisbane services. Further, Qantas plans to add its code to Air Niugini services to Cairns and Townsville.
- In contrast to strong growth historically, Australia-PNG traffic has fallen in recent years, down to levels in FY 2012.
- Australian traffic on the route represented 61% of the O/D market in FY 2017 and continues to be dominated by business and employment travellers, totalling 57% compared with 65% in FY 2016. Inbound visitors are mainly split between holiday and visiting friends and relatives.

Paragraph 5 criteria - competition benefits

- Virgin Australia currently operates 6 B737 services per week and has sufficient allocated capacity to operate 7, and there are 400 seats of unallocated capacity.
- Weakening passenger demand, the presence of other competitors and the potential for new entry continues to act as a competitive constraint on Qantas and Air Niugini.
- PNG Air commenced 3 weekly charter flights in August 2017 under a contract with Newcrest Mining and is reportedly looking at resuming scheduled services to Cairns.
- In its 2016 decision, the Commission questioned whether code sharing on parallel services with Qantas would swing the balance in Air Niugini's favour at the expense of Virgin Australia. However, Air Niugini's share fell by 3.4% in FY 2017, while Qantas' share grew by an equal amount to 19.9%. Virgin Australia's market share fell by the same amount as that of third country carriers grew. In FY17 total market seat factors were 52.2%, similar to the prior FY.
- The PNG ICCC has approved the code share on Brisbane, Sydney and Cairns.
- Qantas and Air Niugini independently price and sell services on the route, with each operating its own yield management systems, creating a genuine competitive dynamic.

Tourism benefits

- In 2016 the Commission considered the tourism criterion was not a significant factor and Qantas anticipates it will adopt a similar approach for this application.
- Notwithstanding this, the code share provides better connectivity and more schedule options than absent the code share.

Consumer benefits

- Consumers can experience 3 differing on board products on Brisbane services, including flat beds in business class on Air Niugini, and the code share supports the viability of each other's services and as a result continuation of a wide degree of choice.
- The benefits on Sydney and Brisbane will be expanded to Cairns and Townsville by providing access to frequent flyer schemes offered by Qantas and Air Niugini and associated benefits.

Trade benefits

- The code share, under which Qantas obtains a hard block on Air Niugini's B767 services, contributes to the availability of frequent, low cost and reliable freight movements. Air Niugini is the only carrier operating wide body aircraft and the frequency of its services is vital for the regular export of time sensitive express products which could not be carried on other capacity in the airfreight market.
- The efficiencies of combined passenger/cargo services provide more competitive cargo rates than dedicated cargo providers.
- The B767 can carry up to 24 tonnes compared to the B737 some 1.5 tonnes of "loose" cargo and Qantas offers its freight customers access to a global network covered by the oneworld alliance. Domestically Qantas has partnered with Australia Post to provide freight and mail services and seamless transfer between international and domestic networks.
- Under the air services arrangements, 60 tonnes per week of all-cargo capacity is available from a total entitlement of 130 tonnes.

Industry structure

- Absent the code share, the more likely outcome would be a reduction in services and competitors on the route, resulting in reduced capacity, less flexible scheduling and a more limited range of fares.
- The code share has supported the viability of Air Niugini and, as such, is of vital importance to the PNG economy. The additional traffic generated by the marketing carrier contributes towards operating costs and allows the operating carrier to maintain and/or operate more services.
- Ending the code share and not authorising the proposed expansion would almost certainly mean reduced Air Niugini's schedules. Adding Qantas' code to Air Niugini's Townsville services should assist in ensuring that the benefits of this service are not lost.
- It is doubtful that Air Niugini could maintain wide body services absent the code share and the replacement of a B767 with a B737 would significantly reduce belly hold space for freight. It is unlikely freighter operators could match the regular schedules from the code share.

MICHAEL MURPHY SUBMISSION, 19 FEBRUARY 2018

- The Commission is urged to give favourable consideration to the code share between Port Moresby and Cairns.
- Port Moresby-Cairns fares, based on a random selection of dates out to September 2018, appear to be higher than in early to mid-2016 and there is no longer an afternoon Cairns to Port Moresby flight.
- Approval of the code share will result in a choice of either Air Niugini or Qantas ticketing and provide some incentive for price competitiveness.

TOWNSVILLE AIRPORT SUBMISSION, 1 MARCH 2018

- Townsville has progressively grown its international footprint since it received approval to operate international flights in February 2015, with Air Niugini coming on board to provide connectivity to PNG and beyond to Asia since 31 March 2017.
- Enabling Qantas to code share on these twice weekly services will expand opportunities to grow and strengthen the route through the expanded distribution potential of Qantas and Qantas frequent flyer.
- We can see the value for the business, education, VFR and tourism sectors both inbound and outbound.
- A confirmation of the code share will go a long way in providing long term sustainability and growth of traffic between Townsville, Port Moresby and Asia.

TOWNSVILLE ClTY COUNCIL SUBMISSION, 2 MARCH 2018

- Air Niugini commenced flights between Townsville and PNG on 31 March 2017 with connections on to Manila and Hong Kong. These services mean Townsville locals no longer have to travel further to access these international destinations.
- Significant economic development has occurred between Port Moresby and Townsville with some $500 million in two-way trade.
- The presence of Youth With a Mission training campus in Townsville and their medical ships that focus on PNG is one example of the strong linkage between the two regions.
- Both Townsville and PNG are keen to see the air service survive and thrive. An expansion of the code share with Qantas will increase the viability of the service and ensure it is sustainable in the long term.
- Townsville - Port Moresby will always remain a low volume route that will only support one carrier. Putting a code share on it will not result in an anti-competitive situation. Instead, approval of the code share will maximise consumer choice.

TOWNSVILLE ENTERPRISE SUBMISSION, 2 MARCH 2018

- Air Niugini would benefit from a Qantas code share through access to Qantas' distribution capability, marketing and airline support.
- It is also important to note that there is no competitor airline on the route.

- Port Moresby is Townsville's oldest sister town with over $500M trade between Townsville North Queensland and Port Moresby.
- The commencement of this route presents significant trade and investment prospects and further potential to strengthen the relationships that already exist.
- This direct air route is an important catalyst to strengthening the relationship and a code share arrangement between Qantas and Air Niugini will support the long-term sustainability of the route.

AIR NIUGINI SUBMISSION, 2 MARCH 2018

- The code share continues to foster greater public benefit by offering freight and passenger customers a wider range of products on Brisbane and Sydney than either carrier could offer separately.
- The code share has allowed Air Niugini and Qantas to maintain robust schedules during weak passenger demand periods and economic challenges for PNG, caused by a dip in commodity prices and the shift of the oil and gas mobilisation phase to the production phase.
- Business clients appreciate the choice of ticketing carrier on multiple departures, the re-entry of Qantas metal on Brisbane and the expansion of Air Niugini services on Sydney.
- The code share has assisted Air Niugini's reach into the Australian domestic market, allowing its customers seamless travel on one airline ticket.
- The code share continues to support the viability of wide-bodied operations on the Brisbane route and both components - passenger and freight - are mutually supportive and vital to the ongoing provision of wide body services.
- Approving the application will mean an increased number of carriers offering services on particular routes, increased competition in fares and increased choice and frequency of services, as well as increased potential to carry freight.
- Cairns remains a difficult route due to declining passenger numbers, high operating costs and significant variation in demand by day of the week and direction. As a result, Air Niugini has gradually decreased services from 15 per week in 2016 to 9 from March/April 2018.

<u>With the code share</u>

- There will two marketing carriers on Cairns and Townsville and with the marketing and distribution strength of Qantas it is likely the viability of these routes will be improved, allowing for an earlier increase in services than might otherwise be possible. The code share should assist in broadening business and trade opportunities between Far North Queensland and PNG.
- There will continue to be one operating and two marketing carriers on Sydney.
- Qantas' support, via its extensive Australian and international network which means it can sell seats on Air Niugini's Brisbane services which Air Niugini could not sell, is critical to Air Niugini's ability to achieve sufficient loads and frequency to make wide body operations viable.
- Customers of both Qantas and Air Niugini continue to enjoy the benefits of choice of operating carrier, schedule, loyalty programs and fares. Freight customers

continue to enjoy the benefits of a daily wide body, palletised solution for the movement of freight.

Without the code share

- There will continue to be only one marketing carrier on Cairns and Townsville and Air Niugini would need to consider carefully the ongoing sustainability of these services in the absence of contributions towards operating costs that would otherwise be earned from Qantas as marketing carrier.
- Air Niugini will be the only operating and marketing carrier on Sydney.
- There is a material risk that without the contribution of revenue from Qantas seat sales towards operating costs on Sydney, Air Niugini will need to either reduce services or withdraw from the route completely if there is insufficient demand to maintain an independent operation.
- This will almost double travel time for Sydney passengers, having to connect via Brisbane, Cairns or Townsville. Direct services save time for business travellers in particular, which stimulates business and trade opportunities.
- On Brisbane, there will be a loss of choice and competition as Air Niugini and Qantas will only be able to offer seats on aircraft they are operating.
- In a mature and stagnant market, the contribution of both passenger and cargo demand is crucial to the viability of wide body aircraft. Absent the code share - for either passenger or cargo - Air Niugini would likely be forced to substantially withdraw from operating wide body aircraft.
- Due to insufficient volume and directional imbalance of demand, it is unlikely that a daily dedicated freight service could be sustained. Prices would need to substantially increase to recover the cost of a daily dedicated freighter to cater for essentially one way demand.

Competition benefits

- The code share will mean more carriers offering services on all routes and will likely result in greater customer choice and lower fares.
- Without the code share there will be less customer choice and competition on all routes, the likely substantial withdrawal of wide body services on Brisbane and the likely reduction and potential withdrawal of Sydney services.
- The code share will enable Air Niugini to operate more efficiently on all routes as it will allow it to achieve higher seat factors as seats can also be sold through Qantas' wider network and marketing channels. Increased efficiency may also enhance customer choice by enabling Air Niugini to respond to fare competition.
- Each carrier will continue to independently set prices, determine its own fare classes and rules, operate its own yield management systems and sell its products through its own independent sales networks.
- On Cairns, Townsville and Sydney, Air Niugini is likely to generate lower passenger yields if operating independently and will face no direct competition. Code sharing on these relatively thin routes will improve patronage and therefore the viability of the routes, making them more sustainable, which in turn may allow service to be increased sooner than would be possible absent the code share.
- On Brisbane, as Air Niugini and Qantas operate their own aircraft each have a very strong incentive to compete vigorously to sell tickets in order to recover their

operating costs. Free sale code share arrangements enable the operating carrier to more efficiently manage capacity and allow the respective marketing carrier uncapped access to the full inventory.

<u>Tourism benefits</u>

- The code share will result in increased service possibilities to and from points beyond Australian gateways or beyond foreign gateways. Air Niugini already code shares on connecting Qantas Australian domestic services and under the code share Air Niugini can market a journey from Port Moresby to Melbourne via Brisbane or Sydney on an Air Niugini ticket with Air Niugini flight numbers.

<u>Consumer benefits</u>

- The code share will result in increased consumer choice of carrier, frequency and preferred times of travel and fares.
- More competitive fares due to greater choice of carrier and efficiencies due to higher load factors.
- Increased opportunity to earn benefits (eg Qantas frequent flyer points and tier status) when code sharing on Air Niugini flights.
- Continued operation of wide body services on Brisbane, with better passenger comfort than narrow body aircraft.
- Increased service possibilities for travellers to Port Moresby or beyond from Australian origins other than Brisbane.

<u>Trade benefits</u>

- The code share will enable Air Niugini to continue to operate wide body services on the Brisbane route, which can carry significant volumes of containerised and palletised freight compared to narrow body passenger services.
- As cargo on wide body passenger flights is carried as supplementary, passenger services can offer lower cargo rates than dedicated freighter operators who, on the PNG route, have to cover the cost of virtually empty aircraft in one direction.
- Air Niugini's wide body services promote Australia – PNG trade through increased availability and lower cost, higher frequency and reliable freight movements.
- Air Niugini would need to substantially withdraw from wide body operations absent the code share (for both passenger and freight). PNG would lose a substantial proportion of commercial air freight and businesses in Australia and PNG would face significantly higher prices and lower frequencies.

VIRGIN AUSTRALIA SUBMISSION, 2 MARCH 2018

- Virgin Australia holds strong concerns regarding the continuation and extension of code share, based on the detrimental impact that it has already had on competition.
- As more than 12 months have elapsed since the implementation of the expanded code share, the Commission can now assess the application against historical data, rather than counterfactual scenarios.

- The commercial performance of Virgin Australia's PNG services has deteriorated significantly since the commencement of the code share arrangements approved in (November) 2016.
- As a result, Virgin Australia has reduced its services from 6 to 5 per week, which has reduced competition and was the outcome Virgin Australia had forecast in 2016.
- Absent the code share, Qantas and Air Niugini would still dominate the Brisbane market, as collectively they hold a passenger market share of 80%, a large premium against their combined capacity market share of 72%.
- Continuation and extension of the code share would enable them to cement their market dominance, which may render services by competitor(s) unviable in the future.
- Virgin Australia's load factor fell from 48.6% in 2016 to 35% in 2017, while Qantas and Air Niugini both recorded increases in their load factors over the same period, to 57.6% and 54.2% respectively.
- Despite offering significantly cheaper average fares in 2017 than its competitors, Virgin Australia was unable to attract sufficient passengers to achieve a reasonable load factor.

<u>Competition benefits</u>

- The detrimental impact of the code share on the commercial performance of Virgin Australia's services provides clear evidence that it has become very challenging for Virgin Australia to compete effectively on the route, given the combined market dominance of Qantas and Air Niugini.
- The current arrangements allow Qantas and Air Niugini to market 60% of all seats on the route, and to add Cairns and Townsville would enable them to hold out for sale 83% of all seats on Australia - PNG flights .
- The continuation of the code share in the Brisbane market will jeopardise the sustainability of Virgin Australia's services to PNG.
- With outbound travel dominated by business traffic, further reductions in services would severely damage Virgin Australia's ability to attract business travellers, curbing its ability to retain and win corporate contracts.
- Virgin Australia has maintained average fares at levels significantly below its competitors and to reduce them is unlikely to boost demand to any material extent, given the route is dominated by price-inelastic business travel.
- Without the ability to increase loads it will become very difficultly to remain in the Brisbane market. This would reduce competition and leave Qantas and Air Niugini as the only operating carriers with negative implications for business travellers and trade.
- Seat capacity shares on the Brisbane route for Air Niugini, Qantas and Virgin Australia are 43%, 33% and 24% respectively. The code share places Virgin Australia at a significant competitive disadvantage, given Qantas' and Air Niugini's combined share is 76%, more than three times Virgin Australia’s. The code share has distorted the competitive landscape by enabling the two largest carriers to strengthen their market dominance, so there are now fewer seats offered by Virgin Australia.
- Termination of the code share would restore competitive balance.

- In its 2016 decisions, the Commission noted in relation to the Brisbane route that it would need to consider whether code sharing on parallel services by Qantas and Air Niugini would swing the balance in Air Niugini's favour at the expense of Virgin Australia.
- The code share has had a significant impact on Virgin Australia’s ability to compete effectively. In stark contrast to Virgin Australia, both its competitors have been able to maintain load factors, with Air Niugini's load factor increasing by 2.1% while Virgin Australia's declined by 13.6%.
- The code share has benefited Air Niugini at the expense of Virgin Australia. This is inconsistent with the object of the Act, particularly concerning the maintenance of Australian carriers capable of competing with foreign airlines.
- If allowed to continue, the code share could jeopardise Virgin Australia’s ability to maintain a presence in the market.
- In a contracting market, it becomes more challenging for other airlines to maintain or increase services in competition with the two strongest carriers and the prospect of entry by another carrier is also likely to be low.
- The commencement of (closed) charters by PNG Air and speculation that it is considering resuming scheduled services have no relevance to RPT flights on the route.
- It is unlikely that services operated via a third country would be an attractive proposition, so the potential for such services to provide an effective competitive constraint on the code share cooperation between Qantas and Air Niugini is extremely limited.
- Qantas' claim that the free sale code share will create a genuinely competitive dynamic is difficult to reconcile with its statements in previous submissions highlighting the importance of a hard block arrangement in promoting competition between it and Air Niugini.
- Contrary to Qantas’ claims that absent the code share there would likely be a reduction in services and competitors, continuation of the code share, rather than removal, would lead to this outcome.
- Qantas' emphasis on the contribution of the code share to the viability of Air Niugini and its associated importance to the PNG economy are not relevant considerations under the Act or the Policy Statement.
- There is no evidence provided to substantiate Qantas's claim that a reduction in Air Niugini's schedules would be an almost certain consequence of the existing code share ending and the proposed expansion not being authorised.
- The appointment of a senior Air Niugini Sales Manager to Townsville suggests Air Niugini's investment in this market is not dependent of the introduction of code share services with Qantas.
- On Sydney the code share is potentially acting as a barrier to entry for another airline. Accordingly, termination of the code share would facilitate competition. Certainly, greater public benefits would be delivered through new entry than a code share on existing services, as recognised in para 3.3 of the Policy Statement.
- Air Niugini performed well on Cairns in 2017, showing that the absence of a code share with Qantas did not have a detrimental impact on its performance. As with Townsville, extending the code share to Cairns would only further consolidate the dominance of the two carriers on the PNG route and make it more difficult for another carrier to enter the Cairns market.

Tourism benefits

- Code sharing on markets between Australia and PNG is not required to enable Qantas and Air Niugini reciprocal access to each others' domestic flights, using their own designator code.

Consumer benefits

- Based on seat factors and market shares, it is evident that the support the code share services are providing to Qantas and Air Niugini is at the expense of Virgin Australia.
- If allowed to continue, the code share may limit Virgin Australia's ability to attract passengers to the extent that its services may not be sustainable. This would see consumer choice reduced. The negative impact of the code share on consumers is already apparent from the reduction in Virgin Australia's services from 6 to 5 on Brisbane.
- Absent the code share it would still be possible to earn and redeem Qantas frequent flyer points on flights operated by Air Niugini.
- Based on industry data, the code share has not delivered materially lower tariffs by either Qantas or Air Niugini on Brisbane.

Trade benefits

- The B767 provides Air Niugini with a significant competitive advantage in attracting freight business, as the only carrier able to transport palletised and containerised freight. This is likely to deliver freight revenues to Air Niugini which makes a strong contribution to the sustainability of its Brisbane services.
- Given the guaranteed revenue stream to Air Niugini from the Qantas hard block of freight capacity on its B767 services, it is quite possible that it is in Air Niugini's commercial interest to maintain wide bodied services, regardless of whether there is a code share in place with Qantas.
- It may also be the case that any decision by Air Niugini to reduce or withdraw wide bodied services would be driven by commercial considerations unrelated to the code share, particularly under a free sale arrangement for passengers which provides no guaranteed revenue to Air Niugini as the operating carrier.
- Any unmet freight demand as a result of a reduction or withdrawal of capacity by Air Niugini would likely see other carriers look to upgrade their cargo carrying capacity. Both Qantas and Virgin Australia have wide bodied aircraft which could be deployed and dedicated freight operations may be increased.

Industry structure

- Virgin Australia's commercial performance has deteriorated sharply since the introduction of the revised code share, leading it to reduce its services on the route.
- If continuation of the code share on Brisbane is approved, it is unlikely Virgin Australia's commercial performance will improve and it may become challenging to maintain a meaningful presence on the PNG route over time.

- This would have potentially serious implications for competition, to the detriment of travellers and the freight sector. It would also weaken Virgin Australia's position in the Australian aviation industry.

Recommendations

- The parallel code share arrangements between Qantas and Air Niugini on Brisbane have allowed the two carriers to concentrate their market power, at the expense of Virgin Australia, the travelling public and the export sector.
- If allowed to continue, the code share will further stifle competition and may result in the route effectively becoming shared between two carriers in a strong commercial relationship. This would likely see fares rise and service options reduced.
- Therefore, the Commission should not vary the determinations as requested by Qantas, at least in relation to Brisbane.
- This is consistent with the fact that up until the Commission's 2016 PNG decisions, it had never allowed two carriers with a dominant position on a route to code share on services which they operate in parallel with each other.
- On Cairns, Sydney and Townsville, the Commission is urged to exercise caution, given that the likely effect of such code sharing would be to foreclose these markets from new entrants.
- If the Commission is inclined to approve code sharing on these markets, it may be appropriate to impose conditions to ensure there is a level of competition between the carriers.

AUSTRALIAN COMPETITION AND CONSUMER SUBMISSION, 14 MARCH 2018

- The ACCC remains of the view that, from a competition perspective, a hard block code share generally is preferable to free sale since it maintains a greater degree of rivalry. The proposed free sale code share reduces the competitive tension between Qantas and Air Niugini.
- Without the code share, Brisbane services would be independently operated and marketed by Qantas, Air Niugini and Virgin Australia.
- If Air Niugini were to significantly raise its price or reduce service on Cairns and Sydney, there would seem to be a real chance that either Virgin Australia or Qantas would enter and contest services. The likelihood of a new entrant providing services on Townsville is less clear, given the low level of traffic on that route.
- With the code share, on Brisbane Qantas and Air Niugini will continue to market each other's services, meaning less competition between the two carriers in marketing their capacity.
- On Sydney, Cairns and Townsville, Qantas will be able to market Air Niugini capacity, which makes it less likely Qantas would commence services in the event Air Niugini was to significantly raise price or reduce service.
- This leaves the threat of entry/expansion by Virgin Australia as the main source of competitive constraint.
- The code share has the potential to lessen competition and there have been developments since 2016 which may indicate that the competitive constraint posed

by Virgin Australia has deteriorated. However, the ACCC is not in a position to form a clear view on the likely extent of the effect on competition.

- Given the uncertainty about the competitive constraint posed by Virgin Australia, the ACCC noted that it is open to the IASC to grant any approval for a shorter duration than requested.
- If the IASC is minded to authorise the code share, the IASC may wish to consider whether conditions are appropriate to address any concerns about the free sale code share diluting the competitive dynamic between the code share partners.

QANTAS RESPONSE TO THE VIRGIN AUSTRALIA SUBMISSION, 15 MARCH 2018

- In its submission Virgin Australia highlighted the unique characteristics of the PNG route, including the high proportion of price inelastic business passengers. As a result, it is unlikely that lower fares can meaningfully stimulate demand. These characteristics are evident in the relatively low load factors of all carriers in 2017 - Qantas 56.8%, Air Niugini 54.1% and Virgin Australia 34.7%.
- Virgin Australia attributed the deterioration of its performance on Brisbane to the support the code share is providing to Qantas and Air Niugini. However, it is by no means clear that the code share rather than the entry of Qantas or commercial considerations unrelated to the code share have influenced Virgin Australia's current position.
- While Qantas frequent flyer points are available for travel on Air Niugini flights absent the code share, the ability to earn status credits and access to Qantas lounges for tiered passengers is not.
- The current environment has led to highly competitive pricing by all three carriers.
- The Commission has previously expressed its concern that a reduction in Air Niugini's services or withdrawal entirely would result in a substantial lessening of competition. Air Niugini has again highlighted its potential vulnerability, including the material risk to Sydney and likelihood of substantially withdrawing from operating wide body aircraft on Brisbane absent the code share.
- Air Niugini is emphatic that both the passenger and freight component of the code share is crucial to the sustainability of wide body operations.
- It is possible that absent the code share Cairns, Sydney and Townsville could continue to be served by a single direct carrier, as with Cairns, with the potential for significantly higher prices and lower frequency. In the absence of a new entrant, greater public benefit would be delivered through retention and proposed expansion of the code share.
- In these circumstances, it is not necessary to impose commercially restrictive and administratively burdensome conditions. The application of conditions has contributed to the market distortions on the PNG route.

QANTAS RESPONSE TO THE ACCC SUBMISSION, 21 MARCH 2018

- The ACCC refers to a hard block generally being preferable to a free sale code share. However, code sharing in all forms has promoted competition in what would otherwise be unserved or monopoly markets.

- In 2016 Qantas and Air Niugini changed the code share to a more sustainable model which better reflects the dynamics of the market.
- Under the free sale for passengers, the marketing carrier has access to the operating airline's seat inventory and independently determines its fares and sells seats on the operating carrier's services. A hard block of freight capacity is obtained on Air Niugini's B767 services. Passengers and freight customers continue to have a genuine choice of whom they buy seats or space from.
- Without the code share, Air Niugini states that this would see the careful review of its services (Cairns and Townsville), material risk of reduced services or withdrawal (Sydney) or likely withdrawal of wide body aircraft (Brisbane).
- Qantas does not support the imposition of conditions that restrict the commercial flexibility of the code share given this is likely to make the services more difficult to sustain over the longer term.