QANTAS

27 February 2012

Ms Sue McIntosh
Executive Director
International Air Services Commission
GPO Box 630
CANBERRA ACT 2601

Dear Ms McIntosh

Review of Code Share Arrangements between Qantas and Air Niugini

Qantas hereby applies for an extension of the authorisations permitting it to code share with Air Niugini on the Papua New Guinea (PNG) route. Qantas wishes to continue to place its code on Air Niugini services between Sydney and Port Moresby, and Brisbane and Port Moresby, and vice versa (the **Codeshare Routes**) in accordance with the Qantas – Air Niugini Code Share Agreement (the **Code Share Arrangement**).

Accordingly, this letter seeks a variation to Determination [2011] IASC 132, which allocates capacity to Qantas on the PNG route, to enable it to use the capacity in code share services with Air Niugini from 1 July 2012 until 30 June 2017.

Qantas believes that the continuation of the Code Share Arrangement offers the best prospect of viable operations on the relevant routes and maximisation of the public benefit by maintaining vigorous and effective competition between the two carriers.

The Code Share Arrangements have continued to provide significant public benefits in the form of efficiencies and lower operating costs, which have in turn provided a wider range of services and networks than could be provided by each carrier operating independently, and the pricing advantages of having two competing carriers selling on each route.

The Code Share Arrangement has also resulted in trade benefits for Australia, including tourism benefits, by stimulating market growth between the two countries despite the volume of traffic between Australia and PNG being small and having limited growth capability.

Code Share Arrangements on these routes have been in place since 1987 and are critical to maintaining air services between Australia and PNG. Qantas and Air Niugini have at all times fully complied with the spirit and intent of the conditions on which the Commission last granted approval.

Qantas prices and sells its services on the route entirely independently of Air Niugini, creating a genuinely competitive dynamic on the routes. In addition, the presence of other competitors, coupled with the potential for new entry, continues to act as a real competitive constraint on both Qantas and Air Niugini. Since the last Determination, overall capacity of the four direct operators on services between Australia and PNG has grown by 29 percent.

Absent the code share arrangements, it is unlikely that the public benefits resulting from the above could be maintained. The more likely outcome would be a reduction in the number of services and competitors on the code share routes and the flow on effects of this including reduced capacity, less flexible scheduling and a more limited range of fares for consumers.

Qantas no longer code shares on Air Niugini's Cairns – Port Moresby vv services after commencing own operated services between these two ports in July 2009.

Qantas has provided supplementary confidential information in the attachment to this letter to assist in the review of these code share arrangements. As this information is commercial-in-confidence, Qantas asks that the attachments not be placed on the public register, nor disclosed to any third party without Qantas' consent.

Paragraph 5 Criteria – Minister's Policy Statement

Qantas believes that this application for the renewal of authorisation of the Code Share Arrangements fully meets the Chapter 5 criteria contained in the Minister's Policy Statement.

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

The Minister's Policy Statement provides that in assessing the extent to which applications will contribute to the development of a competitive environment for the provision of international air services, the Commission should have regard to:

- *the need for Australian carriers to be able to compete effectively with one another and the carriers of foreign countries*
    - The Australia – PNG aviation market only had two competitors when the Qantas – Air Niugini code share relationship was expanded in 2002. Since then, Pacific Blue and Airlines PNG have successfully entered the market and their active presence reflects effective competition.

- the Code Share Arrangements ensure that Air Niugini remains as an operator and key competitor in the market. In turn this delivers public benefits.
- The Code Share Arrangements operate within a contested market in which two Australian carriers and two PNG carriers all compete against each other. In addition, with unallocated capacity under the Air Services Agreeement available, new entry on the relevant routes remains a possibility.
- Under the hard block Code Share Arrangements, Qantas assumes the sole financial responsibility for selling its allocation of seats and both carriers operate independent inventories for the same aircraft, as if two smaller aircraft were flying instead of one large aircraft.
- The structure of the Code Share Arrangement – particularly now that Qantas must purchase a fixed monthly block of space – means that Qantas and Air Niugini must each be highly competitive in order to maximise returns as each airline independently sets its prices, determines its fares and rules attached to each fare, operates its own yield management systems, and sells its products through its respective sales networks, which leads to highly competitive pricing between the two carriers.

- *the number of carriers on a particular route and the existing distribution of capacity between Australian carriers*
  - The number of direct carriers on the Code Share Routes has doubled in recent years and, as the Air Services Agreement between Australia and PNG provides for the designation of multiple carriers, there is scope for more carriers to operate. Both countries also have sufficient negotiated capacity to ensure a commercially viable level of start-up capacity.
- *prospects for lower tariffs, increased choice and frequency of service and innovative product differentiation*
  - The Code Share Arrangements consist of regular direct services on two separate city pairs between the two countries. These operate in addition to both carriers' non-code share services to Cairns. The frequency and schedule choice between the two countries could not be matched if both carriers operated in the absence of the code share arrangement. Both carriers also offer two separate fare structures so the respective fare levels and fare conditions are varied, giving passengers more choice and flexibility. Innovative product differentiation is also ensured by the code share arrangements, as the two carriers each operate own-aircraft services between the two countries and have different "non-flying" products as well, such as frequent flyer benefits and booking and distribution systems. Absent the code share arrangements, it is unlikely that all of these benefits could be provided by both carriers.
- *the extent to which applicants are proposing to provide capacity on aircraft they will operate themselves*

    - Air Niugini operates all of the Code Share services.
    - Qantas operates 12 weekly services between Cairns and Port Moresby using its own aircraft, and Air Niugini operates nine weekly services between Cairns and Port Moresby using its own aircraft. However, these services all operate outside of the code share.
- *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*
    - not applicable
- *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*
    - not applicable
- *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*
    - not applicable

5.1(b) Tourism Benefits

- *the level of promotion, market development and investment proposed by each of the applicants*
    - Given the characteristics of the PNG economy and its small population, the promotion of inbound tourism to Australia is limited. Despite this, Qantas continues to invest in marketing activity and advertising in the PNG market.
- *route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s)*
    - Constraints in the Australia – PNG Air Services Agreement limit Qantas' ability to effectively compete in markets beyond PNG, and Air Niugini's ability to provide services beyond Australia. However, Qantas provides strong links beyond Australia to other points in the Pacific, New Zealand, Asia, North and South America, Europe and South Africa, and Air Niugini operates services to Nadi, Honiara, Tokyo, Manila, Singapore and Hong Kong from Port Moresby that the code share passengers are able to link on to. Both carriers also have extensive domestic networks within their home markets.

In 2011, holidaymakers comprised around 13 percent of the inbound visitor market. This figure has fallen from previous years, where it was above twenty percent. This is perhaps a refection of the enormous growth in the gas and mining industries in PNG, which have increased the business component of this market considerably in recent years. However, as seat capacity continues to grow to match market demand, this situation may reverse in the future.

5.1(c) Consumer Benefits

The efficiencies derived from the Code Share Arrangements have delivered considerable benefits for travellers on the PNG route.

- *the degree of choice (including, for example, choice of airport(s), seat availability, range of product)*
    - Since 2002, the Code Share Arrangements have supported enhanced frequency and capacity on the Australia – PNG route. Capacity has increased through a combination of the use of larger aircraft as well as a greater frequency of services. The number of weekly operated seats provided across the Sydney – Port Moresby and Brisbane – Port Moresby routes has increased from 1,501 to 2,434 since that time, and the number of frequencies has gone from seven to 13.
    - The Code Share Arrangements provide Qantas and Air Niugini with the ability to each sell three city pairs in the Australia – PNG direct market (two of which are part of the code share arrangement). Qantas' Cairns – Port Moresby operations are supported by the code share due to the economies of scope and scale it produces. The Code Share Arrangements maximise the degree of choice in the market as this outcome would unlikely be matched if the code share was not in effect, leading to fewer competitors and/or perhaps fewer city pairs being served.
    - Different aircraft types are operated across these city pairs, which cater for passengers who have strong preferences for particular aircraft.
- *efficiencies achieved as reflected in lower tariffs and improved standards of service*
    - The efficiencies resulting from the Code Share Arrangements have led to development of a wider range of competitive fares, the introduction of direct services between Sydney and Port Moresby (all of which used to operate via Brisbane), as well as the launch of some larger and more modern aircraft operating on the Code Share Routes.
- *the stimulation of innovation on the part of incumbent carriers*
    - Both Qantas and Air Niugini are forced to compete for market share under the terms of the Code Share Arrangements vis-à-vis each other – as well as the other competing carriers on the route - and are, therefore, constantly striving to find innovative ways, such as fare initiatives or frequent flyer program enhancements, to attract more passengers.
- *route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s)*
    - The extensive domestic and international networks of both carriers mean that passengers travelling on the code share services have access to convenient connections to domestic or international flights. This is a particularly important factor for

time-sensitive business travellers when making travel arrangements.

5.1(d) Trade Benefits

- *the availability of frequent, low cost, reliable freight movement for Australian exporters and importers*
  - The Code Share Arrangements dictate that Qantas purchases approximately half the belly hold cargo space on the code share services on a hard block basis. Qantas then sells this cargo space on its own air waybills under the Air Niugini (PX) code, and has the option of taking additional space on a soft block basis if required.
  - This arrangement has delivered competition in the freight market on eight B767 services per week between Brisbane and Port Moresby, and two B767 services per week between Sydney and Port Moresby.
  - The revenues and gross weight of freight carried on these services increased significantly between 2009 and 2011 on ex-Australia services. The ex-PNG services have not fared so well, with a significant fall in revenues and gross weight of freight over this period, although overall revenues and gross weight have grown over the period.
  - The introduction of B767 aircraft on the Australia – PNG route is crucial for the efficient carriage of palletised and containerised freight as a these aircraft can carry up to seven tonnes of freight on services between Brisbane and Port Moresby, whereas a B737 aircraft is typically limited to approximately 1.5 tonnes (depending on passenger loads and aircraft configuration). Air Niugini is the only carrier (passenger or all-cargo) to operate wide-body aircraft on the route
  - Qantas does not sell space on the flights operated by narrow – bodied aircraft as these aircraft have negligible space for freight. Some cargo products, such as fresh seafood, are precluded completely from carriage on these aircraft as they are only able to carry "loose" cargo, in that there is no container or pallet facility available on this aircraft type.
  - The frequency of services provided by the code share means that exporters in Sydney, Brisbane and Port Moresby have a choice of days on which to transport goods and generally more reliable schedules compared to all-cargo operators.
  - Qantas offers its freight customers access to a global route network of 135 countries and territories covered by the **one**world alliance. Domestically, Qantas Freight has partnered with Australia Post to provide freight and mail services, and seamless transfer between international and domestic networks, through Australian Air Express.

5.1(e) Industry Structure

- *The Commission should assess the extent to which applications will impact positively on the Australian aviation industry.*
    - The Code Share Arrangements have seen Qantas continue to provide services between Australia and PNG and produce profits that have enabled it to take the necessary risk to introduce own-operated services on the route. The addition of these services benefits Qantas as well as many ancillary aviation businesses that are related to Qantas' operations.
    - The positive effect of the Code Share Arrangements on Australia's aviation industry also extends to Air Niugini as the Code Share Arrangements not only support the ongoing viability of their operations in an increasingly competitive market, but they have also enabled Air Niugini to add extra services, growing from 15 to 22 services between Australia and PNG since 2002.
    - The continued presence and growth of Qantas and Air Niugini on the Code Share Routes would no doubt have encouraged the entry of Airlines PNG and Pacific Blue in 2005 and 2008 respectively.

Variation Sought

Qantas seeks an extension of the IASC approval to permit Qantas to code share on Air Niugini operated flights on the Code Share Routes for a further five years.

Accordingly, Qantas seeks to vary Determination [2011] IASC 132 to enable Qantas to code share on Air Niugini services operated pursuant to this Determination and in accordance with the Code Share Arrangements of 30 August 2002 – as amended.

The variation is sought with effect from 1 July 2012 to 30 June 2017.

We would be pleased to provide further assistance to the IASC in relation to the attached material should it be required.

Yours sincerely

Tony Wheelens

Tony Wheelens
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