Air Niugini

10th April 2012

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

Dear Ms McIntosh

Re: Review of Code Share Arrangements between Qantas and Air Niugini

Many thanks for your email and advice regarding the application by Qantas for renewal of the Qantas and Air Niugini Code Share arrangements between Sydney/Brisbane and Port Moresby. Air Niugini is aware of the application and will also shortly be submitting an application for approval for the Code Share Renewal to the Independent Consumer and Competition Commission in PNG.

This Code Share arrangement commenced in 2002 and has proved to be a highly successful arrangement for Air Niugini and PNG. The initial agreement was initiated by Air Niugini at a time when the airline was close to insolvency. Thanks to the Code Share, Air Niugini has been able to develop and grow, expanding the fleet and available capacity. We believe that this has enhanced the options for customers in terms of prices offered, frequency of scheduled services, choices of carriers and choice of ancillary consumer features.

The Effect of Non Renewal on the Codeshare

Air Niugini in its submission to the ICCC will argue that the Code Share has been and continues to be to the benefit of the traveling public bringing greater competition between carriers rather than less competition. We will present scenario's which show that overtime without the code share the number of carriers operating would decrease and the use of widebody aircraft would disappear. This will have a deleterious effect on the PNG economy increasing the cost of freight as well as causing PNG airlines to shrink and become less viable than they are with the code share. Freight and passenger services between PNG and Asia will also be effected due to the loss of wide body container freight capable aircraft.

Air Niugini believes that the non renewal of the codeshare will directly impact on staff numbers and job opportunities in a developing airline industry in PNG. It is clear that smaller planes and fewer services would result from the loss of the codeshare and even after the airlines rationalize services, they would still operate at a loss making level.

Since July 2010 there have been no code share services on the Cairns route and by the figures published by the BITRE, load factors for December 2011 (One of the strongest months of the year) were: Qantas 67.6% and Airlines of PNG 53.7%. Although competition on the route is healthy, no airline would appear to be operating at a breakeven load factor.

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Air Niugini believes that a similar situation would occur on the Brisbane/Sydney route if the Codeshare is not approved. Qantas would recommence services in its own right but without the support of a code share partner, demand is insufficient to support high frequency widebody services. Qantas would therefore face a choice in the services it offers – It could offer a low frequency service using widebody aircraft, or it could offer a more frequent service (possibly daily) using a narrowbody aircraft such as a B737 similar to the one currently operated by Virgin in their code share with Airlines of PNG.

As a result of the increased aircraft utilization made possible by the Current Codeshare Agreement, consumers in Papua New Guinea have come to expect high frequency jet services to Australia. Given these expectations, Qantas would be perceived as uncompetitive if it were to offer a service with significantly less than daily frequency. Accordingly, in order to achieve a frequency in the order of 6 services per week, Air Niugini expects that Qantas would commence services using a narrowbody, either a B737 (for a Qantas service) or Airbus A320 (for a Jetstar service). Even so, the introduction of such a service would still introduce substantially more capacity to the market than that lost to Qantas under the codeshare. For example, Air Niugini believes the most likely scenario is that Qantas would introduce at least 6 B737-800 services per week operating between Brisbane and Port Moresby. This would represent an increase of over 56,000 extra seats per annum in each direction. On a route that has a current operating capacity of 144,508 Seats per annum. In other words, the most likely result of Qantas seeking to establish itself with an attractive service on this route would be an increase in capacity on the Brisbane route of approximately 38%.

So, in order to provide a jet service with the level of frequency that consumers in Papua New Guinea have come, under the Current Codeshare Agreement to expect, Qantas would have to increase total capacity in the market by nearly 40%. In the short term this would result in price reductions and a battle for market share as each carrier struggled to attract sufficient customers to make its schedules viable.

In any battle for market share, Qantas holds a number of important advantages over Air Niugini:

(a) Qantas has access to more substantial marketing resources than Air Niugini;
(b) Qantas is a large network carrier. It is therefore able to offer customers discounts on a wide network of routes throughout Australia and more broadly across the world. Its Oneworld alliance membership provides even greater advantages to customers. Air Niugini is unable to match these offers.
(c) Air Niugini expects that Qantas would terminate its reciprocal frequent flyer points agreement with Air Niugini, denying Air Niugini access to this useful marketing tool.

All of these factors mean that without the Codeshare Agreement, Air Niugini's B767 operations between PNG and Australia would incur substantial losses. Confidential financial modeling demonstrating this has previously been provided to the Independent Consumer and Competition Commission in Port Moresby.

In these circumstances, Air Niugini doesn't have the financial resources to "tough out" a sustained battle for market share with Qantas. In the short term, Air Niugini's aircraft lease commitments mean it would be likely to continue to operate widebody B767 services. In order to minimize its losses, however, Air Niugini would have to substantially reduce the number of services it would operate on the codeshare routes. Air Niugini therefore believes that it would be likely to have to reduce its B767 services to two or three concentrated on the strongest traffic days of Monday, Friday and possibly Sunday. Our modeling suggests that this would still be likely to result in losses for Air Niugini's widebody operations.

Air Niugini would be forced to approach the aircraft lessors to try to vacate the lease terms and restructure to a narrowbody aircraft. This would likely also result in a reduction in the number of aircraft making Air Niugini's routes more vulnerable and potentially less reliable.

Loss of Airlines of PNG

As the national carrier, the losses made by Air Niugini would be a direct loss to the people of Papua New Guinea that the nation can ill afford. Government backing however means that Air Niugini would ultimately survive until such time as it could stem the losses by reducing the scale of its business and withdrawing widebody operations. The substantial resources of Qantas mean that it also would survive a period of loss making on Australian routes. The potential government assistance in this scenario is a lost opportunity to provide most needed investment in health, education, roads and other infrastructure. The codeshare agreement precludes the need for government investment in the airline.

Airlines of PNG, however has neither the financial resources of Qantas, nor the ultimate government backing of Air Niugini. Virgin too would face significantly increased competitive pressure likely rendering its codeshare with Airlines PNG unviable. It is therefore likely that the Airlines PNG/Virgin codeshare would not survive the market restructure that would result from the loss of the current codeshare arrangements. The result is that, even if the loss of the Air Niugini / Qantas codeshare resulted in the introduction of one new operating carrier (i.e. Qantas), it would be likely to result at the same time in the loss of two others (Airlines of PNG & Virgin) and the scaling back of Air Niugini's services. The loss of the Air Niugini / Qantas codeshare would therefore ultimately result in no increase in the number of operating carriers, and a reduction in the number of marketing carriers,

Effect on Freight Markets to/from PNG

The removal of widebody operations would effect the cost of freight movements between Australia and PNG as well as between Asia and PNG. Narrowbody aircraft can only carry loose freight rather than the containerized capability of a widebody passenger aircraft. Freight would have to move to dedicated freighter services and freight currently coming direct would most likely have to come via Australia at a higher cost.

PNG exporters would be similarly effected. An immediate example being the large exporters of Tuna to Japan who would have to find alternative means to get their product to market and at presumably a much greater cost as there is no immediate alternative operation. Figures on the value of the PNG export fishing industry are available through the National Fisheries Authority of PNG but conservatively the export market for Tuna alone is in excess of PGK 1 Billion.

Pro-competitive structure of the codeshare

Since early December 2011, the code share agreement only provides for purchasing of hard block seats. These are often higher in number than Qantas normally sells. So, once Qantas has committed to purchase its hard block allocations any unsold seat represents an absolute loss to Qantas. This is a significant and substantial change to the codeshare agreement and responds to concerns raised by the competition regulator in PNG. We are of the view that this form of code share arrangement is recognized by competition regulators around the world as the most competitive form of code sharing arrangement.

Therefore, Qantas has the strongest possible incentive to market its seats on codeshare services aggressively in competition with Air Niugini.

Under the Current Codeshare Agreement each carrier independently from the other:

a) sets its own price;
b) determines its own fare classes and rules;
c) operates its own independent yield management systems; and
d) sells its products through its respective independent sales networks including websites.

This results in a high level of competition between carriers. The result is that, over the period of the Current Codeshare Agreement, Air Niugini's fares have reduced significantly in real terms on every codeshare route.

No constraining of capacity:
As with many markets, competition in airline markets is driven substantially by capacity. The higher level of capacity relative to demand, the higher the pressure on prices. Competition regulators have therefore raised concerns where codeshare arrangements have the effect of constraining capacity on a route.

Average overall load factors achieved on the Codeshare routes over the life of the Current Codeshare Agreement show clearly that the codeshare arrangements have not had the effect of constraining capacity on the codeshare routes.

Other Competitors
In addition to competition between Qantas and Air Niugini over the codeshare routes, there is also effective competition from Airlines PNG and Virgin who similarly operate an approved codeshare on services between Brisbane and Port Moresby.

In November 2008 Airlines of PNG and Virgin Airlines reached agreement on a codeshare for 4 services a week from Brisbane to Port Moresby and return. Both carriers sell and market fares on these services independently.

There are therefore four carriers marketing and selling seats on two operating carrier aircraft. The fact this has been maintained throughout the period of the Current Codeshare Agreement suggests that competition is effective and APNG / Virgin have captured a sustainable percentage of the market.

Summary of Benefits of the Codeshare

The codeshare between Air Niugini and Qantas provides a wide range of benefits for both Air Niugini and the nation of Papua New Guinea as a whole. These can be summarized as:

Competition

The market for air passenger services between Australia (Brisbane & Sydney) and Papua New Guinea is currently served by two operating carriers, Air Niugini and Virgin. After the restructure that would follow the loss of the current codeshare arrangements between Air Niugini and Qantas, there would likely be two operators, Air Niugini and Qantas and neither airline would operate widebody aircraft.

It is therefore likely that the loss of authorization of the Renewed Codeshare Agreement would lead to a less efficient and, ultimately less competitive market structure than authization of the Renewed Codeshare Agreement.

Freight

The economy of Papua New Guinea is highly dependent on air freight services. Most of the nations fresh dairy products, fruits and vegetables are imported by air freight. Similarly, the nations seafood and other exports rely on the availability of efficient air freight services. Further, most of the resource projects expect to airfreight their cargo via Asia due to high frequency operations to these locations from China, Europe and USA. The loss (if widebody operations were withdrawn) of direct air freight services to any of Japan, Singapore, Hong Kong or the Philippines would mean that both importers and exporters would have to pay more to ship their freight via Australia and then ship it to or from Papua New Guinea. The effect on the important and highly perishable fishing industry would potentially be devastating.

National Economy

As described above the loss of the Codeshare would result in substantial financial losses to Air Niugini. Since Air Niugini is a national carrier, these losses represent a direct loss of government funds that would otherwise be available for welfare or infrastructure spending for the benefit of the nation.

In addition the restructure that would be necessary without the codeshare may result in increases to the break even prices domestically as well as internationally. This could result in increases in domestic airfares and a reduced ability for the airline to continue to operate loss making or marginal domestic routes which are currently carried out as a community service obligation.

Employment

Loss of the codeshare would result in the direct loss of at least 500 jobs almost immediately and this number would be likely to increase. Air Niugini estimates that it would be forced to bring its workforce down to around 1300 jobs from the current level of over 1900 staff. The flow effect of higher air freight costs is also likely to cost many more jobs in PNG.

Improvement to services

The codeshare arrangements with Qantas allow a higher standard of services to be provided to Papua New Guinean consumers in a range of ways. The codeshare has allowed the operation of direct flights from Sydney which would not be viable without the codeshare.

Conclusions

For all of the reasons outlined here, Air Niugini believes that its codeshare arrangements with Qantas lead to very substantial public benefits, whilst resulting in either no substantial lessening of competition, or a strengthening of competition in all affected markets.

Yours sincerely

Wasantha Kumarasiri
Chief Executive Officer
Air Niugini limited