AUSTRALIAN COMPETITION
& CONSUMER COMMISSION

Level 2,
23 Marcus Clarke Street
Canberra ACT 2601

GPO Box 3131
Canberra ACT 2601

tel: (02) 6243 1111

www.accc.gov.au

Our ref: IASC 60232
Contact officer: Darrell Channing
Contact phone: 02 6243 4925

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

Via email: iasc@infrastructure.gov.au

Dear Ms Tucker

**Re: Qantas' Application for variation of determinations – Australia/Papua New Guinea Route**

I refer to the letter from Dr Ian Douglas to Mr Rod Sims on 28 February 2018 inviting the ACCC to make a submission with respect to Qantas' application to vary Determinations [2016] IASC 110 and [2014] IASC 105 as varied. Mr Sims has asked me to respond on his behalf.

**The application for variation**

The ACCC understands that there are three key aspects of Qantas' application:

- A continuing code share arrangement with Air Niugini on services between Sydney-Port Moresby and Brisbane-Port Moresby for the duration of determinations [2014] IASC 105 and [2016] IASC 110 (**the Codeshare period**).[1]

- Adding a code share arrangement with Air Niugini on services between Cairns-Port Moresby and Townsville-Port Moresby for the Codeshare Period.

- The code share arrangement to be free sale on all routes.

**Requirements under the Minister's policy statement**

The ACCC understands that in circumstances where the IASC has serious concerns that a code share arrangement may not be of benefit to the public, the IASC may apply certain 'public benefit' criteria set out in paragraph 5 of the *International Air Services Policy*

[1] On the Australia-PNG route, determinations [2014] IASC 105 and [2016] IASC 110, respectively, grant Qantas 888 seats until route until 23 March 2020 and 1000 seats until 30 June 2022.

*Statement No.5* [2] (including competition benefits[3]) in its assessment of code share proposals. Before doing so, the IASC must consult the ACCC.

In this submission, the ACCC identifies a number of issues which are relevant to assessing the likely competitive impact of the proposed code share arrangement and whether it is likely to be of benefit to the public.

**The nature of the code share arrangement between Qantas and Air Niugini**

As noted above, the ACCC understands that the code share arrangement is to be free sale on all routes identified in the application for variation.

The ACCC's views on free sale versus hard block code share arrangements were set out in detail in its submission to the IASC on the application for variation lodged by Qantas in 2016.[4]

The ACCC notes that the IASC raised concerns about the nature of the code share arrangement between Qantas and Air Niugini in its 2007, 2009 and 2012 decisions. In particular, the IASC was concerned about the small size of the hard block component of the arrangement and that allowing Qantas to match flight seat numbers to forecast demand (to some extent) put limited pressure on Qantas to compete on price with its code share partner.

The ACCC remains of the view that, from a competition perspective, a hard block code share generally is preferable to a free sale code share since it maintains a greater degree of rivalry between the airlines. The free sale nature of the proposed code share reduces the competitive tension between Qantas and Air Niugini in the arrangement, and any claimed competition benefits need to be considered in this context.

**Likely future with and without the arrangement**

It will be important for the IASC to compare the likely future with and without the code share arrangement in place in its assessment of competition or any other benefits.

The ACCC considers that in the likely future without the code share arrangement in place:

- Services between Brisbane-Port Moresby would be independently operated and marketed by Qantas, Air Niugini and Virgin.
- Services between Cairns-Port Moresby, Sydney-Port Moresby and Townsville-Port Moresby would be operated and marketed by Air Niugini. In the event that Air Niugini were to significantly raise its price or reduce service, there would seem to be a real chance that either Virgin or Qantas would enter and contest services between Cairns-Port Moresby and Sydney-Port Moresby. The likelihood of a new entrant providing services between Townsville and Port Moresby is less clear given the relatively low volume of traffic on that route.

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[2] Made under the *International Air Services Commission Act* (1992), section 11.

[3] *International Air Services Policy Statement No.5,* paragraph 5.1(a)

[4] Letter from the ACCC to the IASC dated 6 October 2016, pages 2 - 4.

**Competition benefits**

Under the proposed code share arrangement:

- On the Brisbane-Port Moresby route, Qantas and Air Niugini will continue to be able to market each other's services, meaning there will be less competition between the two carriers in the marketing of their capacity.

- On the Sydney-Port Moresby, Cairns-Port Moresby and Townsville-Port Moresby routes, Qantas will be able to market Air Niugini capacity, which makes it less likely that Qantas would commence operating on the route in the event that Air Niugini were to significantly raise price or reduce service.

- This leaves the threat of entry/expansion by Virgin as the main source of competitive constraint on these routes.

The ACCC notes that since the IASC's 2016 assessment of the code share arrangement between Qantas and Air Niugini:

- Overall seat capacity and passengers on the Brisbane-Port Moresby route grew by 8% and 6% respectively between 2016 and 2017.

- Virgin submits that the codeshare arrangement has had a detrimental effect on the sustainability of its Brisbane-Port Moresby services. In February 2018, Virgin reduced its services on the Brisbane-Port Moresby route from six frequencies per week to five.

- Virgin submits that the code share arrangement is a barrier to another airline entering on the Sydney-Port Moresby route.

- Virgin submits that Air Niugini is performing at a level where it is no longer dependent on the codeshare to remain viable on the Cairns-Port Moresby and Townsville-Port Moresby routes.

Virgin's submission to the IASC indicates that in 2017 its load factor and passengers carried decreased markedly. Further investigation would be needed to better understand the extent to which this was caused by Virgin increasing yields and average fares on this route or whether the codeshare arrangement is conferring a significant competitive advantage to its rivals.

There appears to be a real chance that Virgin's ability to constrain the price and service decisions of Qantas and Air Niugini, particularly on the Brisbane-Port Moresby route, has deteriorated since the IASC's 2016 assessment. However, in order to properly assess the likely effect on competition of the variation sought, more information should be considered, including examining trends over a longer period than one year. In particular, the ACCC considers that the IASC will need to have regard to:

- time-series load factor data for all airlines operating on the relevant routes

- time-series profitability and yield data for all airlines operating on the relevant routes

- time series individual route passenger numbers

- information about how Virgin would now be likely to respond to higher prices or reduced service by Qantas and/or Air Niugini, given its recent experience on the Brisbane to Port Moresby route (i.e. is there now less chance that Virgin would be likely to commence services on these routes in response to an increased in price or reduction in service?).

The ACCC also notes that the IASC has authorised code sharing between Qantas and Air Niugini on a continuing basis since 2002. The ACCC understands that part of the rationale for this original approval was Air Niugini's financial difficulties at that time and the risk that it might not be able to operate services between Australia and Papua New Guinea. In assessing the current data for all the airlines operating on the relevant routes, the IASC may wish to consider whether that part of the underlying rationale remains relevant today.

**Conclusion**

The ACCC considers that the code share arrangement has the potential to lessen competition and there have been developments since the IASC's 2016 assessment which may indicate that the strength of the competitive constraint posed by Virgin has deteriorated.

However, without the opportunity to examine the further information outlined above, the ACCC is not in a position to form a clear view on the likely extent of the effect on competition.

In these circumstances, the ACCC has outlined a number of issues for the IASC to consider and anticipates that the IASC will examine any competition benefits by comparing the likely future with and without the code share arrangement.

**Period of approval**

The ACCC understands that Qantas seeks approval for its proposed code share arrangements for the Codeshare Period. Given the uncertainty about the competitive constraint posed by Virgin, the ACCC notes that it is open to the IASC to grant any approval for a shorter duration than requested.

**Conditions of approval**

The ACCC notes that the IASC has previously imposed conditions of approval designed to encourage competition between the code share partners, such as minimum numbers of weekly frequencies which must be operated, and independent pricing.

If the IASC is minded to authorise the code share arrangement, it may wish to consider whether conditions are appropriate to address any concerns about the free sale code share arrangement diluting the competitive dynamic between the code share partners.

**Role of the ACCC**

I note that any decision by the IASC to approve the code sharing arrangements between Qantas and Air Niugini does not provide any protection for the airlines under the *Competition and Consumer Act 2010* and does not prejudice any possible future consideration of code share operations by the ACCC.

I hope that this submission assists you in your consideration of the application from Qantas.

If you wish to discuss any aspect of this submission further, please do not hesitate to call Darrell Channing on 02 6243 4925.

Yours sincerely

David Jones
General Manager
Adjudication