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2 March 2018

Ms Marlene Tucker
Executive Director
International Air Services Commission
PO Box 630
CANBERRA ACT 2601

Dear Ms Tucker

Re: Variation application – Papua New Guinea

I refer to the invitation from the Commission to provide a submission in relation to Qantas Airways' application dated 16 February 2018 requesting variation of the determinations it holds on the Papua New Guinea route. Please find enclosed with this letter the non-confidential version of Virgin Australia's submission.

Should you wish to discuss any aspect of our submission, please do not hesitate to contact Lee-Anne Tomkins on (02) 8093 7114.

Yours sincerely

Jane McKeon

Jane McKeon
Group Executive
Government Relations

VIRGIN AUSTRALIA

SUBMISSION IN RELATION TO QANTAS AIRWAYS' APPLICATION FOR VARIATION – PAPUA NEW GUINEA ROUTE

Virgin Australia holds strong concerns regarding the continuation and extension of code share cooperation between Qantas Airways' (Qantas) and Air Niugini on the Papua New Guinea (PNG) route, as proposed by Qantas in its current application to the International Air Services Commission (the Commission) for variation of Determinations [2016] IASC 110 and [2014] IASC 105. These concerns are based on the detrimental impact that code share cooperation between Qantas and Air Niugini has already had on competition on the route, with corresponding implications for the travelling public and Australia's export sector.

Under the *International Air Services Commission Act* (the Act), the Commission must not make a decision varying a determination as requested under a transfer application if it is satisfied that the allocation as varied would not be of benefit to the public (section 25 (2)). Section 26 of the Act requires that in assessing the benefit to the public of a variation of an allocation of capacity, the Commission must apply the criteria set out for that purpose in any policy statements made by the Minister under section 11. Paragraph 5.2 of the Minister's Policy Statement provides that in applying the additional criteria in paragraph 5.1, the Commission should take as the preeminent consideration, the competition benefits of each application.

As more than 12 months have elapsed since the implementation of the expanded code share cooperation between Qantas and Air Niugini, the Commission now has the opportunity to assess Qantas' application against historical data, rather than potential counterfactual scenarios. In this regard, the commercial performance of Virgin Australia's services to PNG has deteriorated significantly since the commencement of the code share arrangements, following Decisions [2016] IASC 220, [2016] IASC 221 and [2016] IASC 222 approving such cooperation until 30 June 2018. As a result of this deterioration, the operation of six frequencies per week in the market was no longer sustainable and resulted in a decision to reduce our schedule to five frequencies per week from February 2018, with the removal of our Sunday service. This has weakened competition on the route and was the outcome that our submission in relation to Qantas' application in 2016 had forecast would occur.

In addition, Virgin Australia queries a number of the general and/or unsubstantiated claims made by Qantas in its application addressing each of the paragraph 5 criteria, which seek to justify its request for continued code share cooperation with Air Niugini on the basis of the public benefits that such cooperation would deliver. Given the longstanding concerns expressed by the Commission regarding the competition implications of the code share services between the two carriers, Virgin Australia suggests that the veracity of such claims should be carefully assessed.

We also note that the statistics quoted by Qantas in its submission regarding passenger volumes, market shares, load factors and freight volumes are based on FY17 data only. An accurate assessment of the impact of the code share arrangements requires examination of the most recent data available. Accordingly, the statistics included in our submission are based on data for the 12 months ending November 2017, wherever such data is available.

Absent the code share arrangements between them, Qantas and Air Niugini would still dominate the Brisbane-Port Moresby market, as they collectively hold a passenger market share of 80%, representing a large premium against their combined capacity market share of 72%.[1] Continuation and extension of the code share cooperation between the carriers would enable them to cement their dominance in the market, creating the conditions which may render the operation of services by competitor(s) on the route unviable in the future. In Virgin Australia's view, such an outcome would be inconsistent with the Act's primary objective of enhancing the welfare of Australians by promoting economic efficiency through competition in the provision of international air services.

Virgin Australia's presence on the PNG route

Virgin Australia holds capacity allocations totalling 1,232 seats per week on the PNG route. We commenced services to PNG in November 2008 under the Pacific Blue brand, with the operation of four weekly frequencies between Brisbane and Port Moresby. A fifth service was added to our schedule in April 2012, followed by a sixth service in July 2014.

We currently operate five frequencies per week on the route with B737-800 aircraft, following the removal of the Sunday service in February 2018. This equates to a 17% reduction in Virgin Australia's capacity on the route.

Recent trends on the PNG route

Between 2013 and 2017, the number of passengers travelling on the PNG route fell by 9%, while industry seat capacity increased by 2%.[2] Between 2016 and 2017, passenger numbers were almost flat on seat capacity growth of 1%.[3] In 2017, Qantas and Air Niugini carried 87% of all passengers on the route, which was an increase from 81% carried in 2016.[4] Virgin Australia carried the remainder of passengers on the route during these years.

Across all markets, the load factor achieved by all carriers in 2017 was 51.3%.[5] While Qantas and Air Niugini recorded load factors of 57.6% and 54.2% respectively, Virgin Australia achieved a load factor of 35.0% – more than 16ppts below the average load factor for all carriers on all routes.[6]

During FY17, Australian residents accounted for more than 60% of travellers on the route.[7] For Australian resident departures in FY17, the route continued to be dominated by passengers travelling for business-related purposes[8], at 61%.[9] For visitor arrivals over this

[1] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.
[2] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2013 and November 2017.
[3] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2016 and November 2017.
[4] Ibid.
[5] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.
[6] Ibid.
[7] Australian Bureau of Statistics, Overseas Arrivals and Departures, FY17.
[8] Business-related purposes includes reasons of Business, Convention, Education, Employment and Exhibition.
[9] Australian Bureau of Statistics, Overseas Arrivals and Departures, FY17.

period, the holiday and visiting friends and relatives categories collectively represented 64% of travellers on the route, with business travel comprising 28%.[10]

Freight on the PNG route is carried on combination passenger/cargo flights operated by Virgin Australia, Air Niugini and Qantas, as well as on two B737-300 dedicated freighter services operated each week by Pacific Air Express Australia, utilising 35 tonnes of the 52.5 tonnes of dedicated freighter capacity it has been allocated by the Commission. Qantas also holds an allocation of 17.5 tonnes of dedicated freighter capacity on the route, which is not utilised at present according to the Department of Infrastructure, Regional Development and Cities' (the Department) Northern Winter 2017-18 Timetable Summary.

Total freight[11] volumes on the PNG route fell by 37% between 2013 and 2017, although a very small increase of 1% was recorded between 2016 and 2017.[12] Air Niugini dominates the freight market on the route, with a 74% share, followed by Pacific Air Express Australia with a share of 18%.[13] In the Brisbane-Port Moresby market, Air Niugini increased its freight volumes by 137 tonnes or 5% between 2016 and 2017.[14] Virgin Australia's market share remains modest, at 222 tonnes or 6% in 2017.[15]

In relation to Qantas' statement in its submission that the "Australia-PNG market exhibits many characteristics that make it unique among Qantas' routes", we note that no information regarding such characteristics has been provided beyond commentary on recent trends in the passenger market.

Commercial performance of Virgin Australia's services on the PNG route

The commercial performance of Virgin Australia's services 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. This deterioration forced us to review our capacity in the market, which eventuated in the removal of our Sunday service, as noted above.

Overall seat capacity and passengers on the Brisbane-Port Moresby market grew by 8% and 6% respectively between 2016 and 2017.[16] While Virgin Australia's seat capacity decreased marginally by 3% during this period, the number of passengers carried on our services fell by 30%.[17] In sharp contrast to Virgin Australia, Air Niugini did not record a disproportionate fall

[10] Ibid.
[11] Includes mail.
[12] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2013, November 2016 and November 2017.
[13] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.
[14] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2016 and November 2017; assumes all cargo carried by Qantas between October 2016 and November 2017 was carried on the Brisbane-Port Moresby market.
[15] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.
[16] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2016 and November 2017.
[17] Ibid.

in its passenger volumes in the market over this time, with its passengers decreasing by 32% on a capacity reduction of 35%.[18]

While Virgin Australia's passenger and capacity market shares were almost equivalent in 2016 (29.7% and 31.2% respectively), a large disparity between these metrics emerged in 2017.[19] Our passenger market share in 2017 was 19.6%, compared to our capacity market share of 28.0%.[20] The divergence between these two market share metrics is reflected in the dramatic decline in our load factor.

Virgin Australia's load factor fell from 48.6% in 2016 to 35.0% in 2017, while Air Niugini's load factor strengthened by 2.1ppts to 54.3% over the same period.[21] The Qantas services achieved a load factor of 57.6% in 2017 – more than 22ppts higher than Virgin Australia's load factor.[22] The load factors recorded by the three carriers serving the route are shown in the table below.

Brisbane-Port Moresby vv	**Load factor[23]**		
	2016 (%)	**2017 (%)**	**Variance (ppts)**
Air Niugini	52.2	54.3	+2.1
Qantas	50.4[24]	57.6	+7.2
Virgin Australia	48.6	35.0	-13.6

[CONFIDENTIAL MATERIAL REDACTED]

Despite the fact that the average fares we offered in 2017 were significantly cheaper than those offered by our competitors, we were unable to attract sufficient passengers to achieve a reasonable load factor.[25]

[CONFIDENTIAL MATERIAL REDACTED]

Response to Qantas' application addressing the paragraph 5 criteria

Competition Benefits

Paragraph 5.1 (a) 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 a number of considerations, including:

- the need for Australian carriers to be able to compete effectively with one another and the carriers of foreign countries;

[18] Ibid.
[19] Ibid.
[20] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.
[21] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2016 and November 2017.
[22] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.
[23] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2016 and November 2017.
[24] Includes Qantas operations in November 2016 only
[25] Internal Virgin Australia reporting; IATA Direct Data Solutions Ticket Detail report, 12 months ending November 2017.

- the number of carriers on a particular route and the existing distribution of capacity between Australian carriers; and

- prospects for lower tariffs, increased choice and frequency of service and innovative product differentiation.

As noted in our submission to the Commission's consideration of Qantas' application in 2016, the code share arrangements between Qantas and Air Niugini are, of themselves, the single most significant characteristic of the PNG route. The detrimental impact that these arrangements have had on the commercial performance of Virgin Australia's services since their implementation 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 code share arrangements allow the carriers to market 60% of all seats offered on the route.[26] If the Commission was to endorse the expansion of code share services to include the Cairns and Townsville markets, this would enable Qantas and Air Niugini to hold out for sale 83% of all seats on flights between Australia and PNG.[27]

For the Brisbane-Port Moresby market, the continuation of the code share services will jeopardise the sustainability of our services to PNG. Virgin Australia's options to improve the commercial performance of our flights are extremely limited. With outbound travel to PNG dominated by business traffic, further reductions in our schedule would severely damage our selling proposition with the business traveller, curbing our ability to both retain and win corporate contracts on the route. We have maintained our average airfares at levels significantly below our competitors and reducing our airfares is unlikely to boost demand for our services to any material extent, given the route is dominated by price-inelastic passengers travelling for business purposes, and would simply result in the cannibalisation of the revenue we would otherwise earn for our services.

Virgin Australia now finds itself in a position where, based on current levels of demand, it has become extremely challenging to attract the passenger volumes required to sustain an operation of five frequencies per week. Without the ability to increase our loads, it will become very difficult for us to maintain our presence in the Brisbane-Port Moresby market in the future. This would reduce competition and leave Air Niugini and Qantas as the only carriers operating services between Australia and PNG, with negative implications for business travellers, tourism and trade, particularly given that 66% of all passengers on the route travel to/from Brisbane.[28]

In the Brisbane-Port Moresby market, the seat capacity shares for Air Niugini, Qantas and Virgin Australia are 43%, 33% and 24% respectively.[29] The existing code share arrangements have placed us at a significant competitive disadvantage, given that Qantas and Air Niugini's combined share of 76% is more than three times the capacity we offer.[30] They have distorted the competitive landscape by enabling the two largest carriers to strengthen their market dominance, with the result that there are now fewer seats offered by

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[26] Based on a sample week in February 2018.
[27] Ibid.
[28] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.
[29] Based on a sample week in February 2018.
[30] Ibid.

Virgin Australia on the Brisbane-Port Moresby route than before the code share services were introduced. Accordingly, competition in the market has been diminished. Termination of the code share arrangements would restore competitive balance in the market and deliver net public benefits.

In its 2016 decisions, the Commission noted in relation to the Brisbane-Port Moresby market that it would need to consider "…whether code sharing on parallel services by Qantas and Air Niugini will swing the balance in favour of Air Niugini at the expense of Virgin Australia."[31] Based on the material provided regarding the recent commercial performance of our services, it is evident that the code share services have had a significant impact on our ability to compete effectively with Air Niugini and Qantas. In stark contrast to Virgin Australia, both of our competitors have been able to maintain load factors on the Brisbane-Port Moresby market which exceed the average load factor for all markets on the PNG route.[32] Air Niugini's load factor has increased by 2.1ppts, compared to the decline of 13.6ppts recorded by Virgin Australia.[33] Undoubtedly, the code share services have benefitted Air Niugini at the expense of Virgin Australia. Such an outcome is inconsistent with the object of the Act, particularly as it concerns the maintenance of Australian carriers capable of competing effectively with airlines of foreign countries. If allowed to continue, the code share services have the potential to jeopardise Virgin Australia's ability to maintain a presence in the market, which would reduce choices available to consumers and limit scope to support the growth of Australian tourism and trade. These outcomes would also be inconsistent with the object of the Act.

As noted above, passenger volumes on the PNG route have been falling in recent years. In a contracting market, it becomes more challenging for other airlines to maintain or increase their services in competition with Qantas and Air Niugini as the two strongest carriers on the route. In this scenario, the prospect of entry by another carrier is also likely to be relatively low. From this perspective, we would challenge the statement in Qantas' submission that, "Against the background of weakening passenger demand, the presence of other competitors and the potential for new entry continues to act as a competitive constraint on both Qantas and Air Niugini."

Qantas' submission notes that PNG Air has commenced charter flights to Australia. These flights are closed charter operations on behalf of a client in the mining industry and therefore have no relevance to scheduled regular public transport flights on the PNG route.[34] Speculation that PNG Air is considering resuming scheduled flights to Australia is also irrelevant.

Claims in Qantas' submission that, "…third country carrier traffic grew by 2.5 percentage points to 14.6 per cent total market share in FY17," would seem to be based on Australian Bureau of Statistics (ABS) data drawn from information recorded on passenger arrival and departure cards. This data relies on information provided by passengers, some of whom may have completed their cards with reference to onward travel to countries other than

[31] Decisions [2016] IASC 220, [2016] IASC 221 and [2016] IASC 222, paragraph 8.15.
[32] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.
[33] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2016 and November 2017.
[34] http://www.pngair.com.pg/en/news/, Media Announcement, Newcrest Mining signs up PNG Air, 23 June 2017.

Australia and PNG. In contrast, reporting produced by the Bureau of Infrastructure, Transport and Regional Economics (BITRE) is compiled based on data provided directly by airlines. For the Commission's assessment of current passenger, capacity and market share trends on the PNG route, the reporting produced by the BITRE is the most relevant and reliable source of information. When evaluating the impact of the existing code share, comparison of the most recent data (12 months ending November 2017) rather than a financial year basis is appropriate, as this aligns more closely with the period of change on the route under review.

As Philippine Airlines is the only third country carrier serving both Australia and PNG, it should be the only airline for which third country carrier traffic on the route is recorded. Philippine Airlines carries an extremely small volume of PNG resident/destined traffic out of Australia. Review of the ABS dataset shows that other airlines[35] are also included as third country carriers, even though they do not serve the route through either own aircraft operations or code share services. Accordingly, closer examination of the referenced third country carrier data indicates there is potential for erroneous conclusions to be drawn on the Australia-PNG market using this ABS data in isolation.

It is unlikely that services operated between Australia and PNG via a third country would be an attractive proposition in any event, particularly for the business traveller, due to the additional travel time involved with an indirect routing. The potential for such services to provide an effective competitive constraint on the code share cooperation between Qantas and Air Niugini is therefore extremely limited.

Qantas' submission notes that it and Air Niugini, "…independently price and sell services on the PNG route with each operating its own yield management systems, creating a genuinely competitive dynamic." As the code share services are now structured on a free sale basis, this claim is difficult to reconcile with statements made by Qantas in previous submissions to the Commission highlighting the importance of a hard block arrangement in promoting competition between itself and Air Niugini.

Qantas also claims that absent the code share arrangements, it is likely there "would be a reduction in the number of services and competitors on the PNG route" and the flow-on effects of this would include "reduced capacity, less flexible scheduling and a more limited range of fares for consumers." Virgin Australia asserts that the continuation and extension of the code share services, rather than their removal, would in fact lead to the outcomes suggested by Qantas. This view is based on the recent and current commercial performance of our services, as outlined above.

Virgin Australia notes that the Qantas submission places a heavy emphasis on the contribution of the code share arrangements to the viability of Air Niugini and its associated importance to the PNG economy. However, these are not relevant considerations under the Act or the Minister's Policy Statement. This is consistent with the Commission's statement at paragraph 8.15 of it 2016 decisions that, "…the Commission's responsibility under the Act and the Minister's policy statement is towards Australian carriers and their ability to compete in international markets, and it is required to assess the impact of applications on the Australian aviation industry."

[35] Including Air Asia X, Air New Zealand, Emirates and Singapore Airlines.

Qantas' submission asserts that, "A reduction in Air Niugini's schedules would be an almost certain consequence of the existing code share arrangements ending and the proposed expansion not receiving authorisation." There is no evidence provided to substantiate this claim, aside from a reference to recent reports which suggest Air Niugini is considering dropping its Port Moresby-Townsville flights due to low passenger numbers. This claim was refuted by Air Niugini according to a report in the Townville Bulletin on 23 February 2018. The Air Niugini spokesman quoted in the report did not make any statements to the effect that the introduction of code share services on the Townsville market was necessary to support the viability of these services, and instead commented that, "…a senior member of our Australian team will be posted to Townsville this March as Air Niugini Sales Manager."[36] This suggests Air Niugini's continued investment in this market is not dependent on the introduction of code share services with Qantas. The extension of code share services to this market would further entrench the dominant position that Qantas and Air Niugini already hold on the PNG route and likely foreclose the market from entry by competitors.

Virgin Australia is of the view that the code share arrangements in effect with Qantas for Air Niugini's services on the Sydney-Port Moresby market are potentially acting as a barrier to entry for another airline to mount a competitive and sustainable operation. Accordingly, termination of the code share arrangements could facilitate competition in the provision of direct services in this market that would not otherwise have occurred or would have been delayed. Certainly, greater public benefits would be delivered through the entry of a new operator on the route, compared with a code share on existing services, as recognised in paragraph 3.3 of the Minister's Policy Statement.

On the Cairns-Port Moresby market, we note that Air Niugini's services performed well in 2017, achieving a 56.3% load factor and enjoying passenger growth of 49% on seat capacity growth of 40%.[37] These figures clearly show that the absence of a code share with Qantas has not had any detrimental impact on the commercial performance of Air Niugini's services in this market. Accordingly, and similar to the case of Townsville, there is no justification for extending the code share arrangements to this market, as this would only serve to further consolidate the combined dominance of the two carriers on the PNG route and render it more difficult for another carrier to enter the Cairns market in the future. From this perspective, the prospects for enhanced competition in the market would be supported by not permitting code share services to be introduced.

<u>Other Benefits</u>

Other benefits to be assessed by the Commission under paragraph 5 of the Minister's Policy Statement comprise those related to tourism, consumers, trade and industry structure.

Tourism Benefits

For tourism benefits under paragraph 5.1 (b), in assessing the extent to which applications will promote tourism to and within Australia, the Commission should have regard to:

[36] *Townsville Bulletin*, "Niugini's Moresby run 'OK'", 23 February 2018, page 12.
[37] Bureau of Infrastructure, Transport and Regional Economics, International airline activity, 12 months ending November 2017.

- 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).

In its 2016 decisions, the Commission noted that the growth potential of the PNG inbound tourism market is limited due to the country's small population and low average incomes. The Commission went on to suggest, however, that "to the extent that the code share keeps Air Niugini in the market and provides some price competition, it is likely to be a positive factor in the development of the small market that does exist. This benefit would be negated if as a result of the Qantas-Air Niugini partnership, Virgin Australia were to reduce its services or vacate the route."[38] Given that we have reduced our services since the code share arrangements were implemented, we would anticipate that the Commission would continue to assign low importance to the tourism criterion in assessing Qantas' application.

Notwithstanding the limited potential for tourism benefits to be realised on the route, we note that Qantas has not provided any material in its submission regarding the promotion, market development or investment it will make in relation to the PNG route in connection with the code share proposal.

In relation to route service possibilities to and from points beyond Australian gateways or beyond foreign gateways, passengers travelling on Qantas' services on the Brisbane-Port Moresby market and beyond on an Air Niugini flight to another destination in PNG would still have the ability to travel under the QF designator code for the entire journey, absent parallel code share services on the Brisbane-Port Moresby market. In the same way, passengers travelling on Air Niugini's services between Port Moresby and each of the four gateways it serves in Australia would still have the ability to travel to other Australian destinations on flights operated by Qantas under the PX designator code. Code sharing on markets between Australia and PNG is not required in order to enable reciprocal access to be offered by Qantas and Air Niugini to each other's domestic flights.

Consumer Benefits

For consumer benefits under paragraph 5.1 (c), 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

[38] Decisions [2016] IASC 220, [2016] IASC 221 and [2016] IASC 222, paragraph 8.19.

– route service possibilities to and from points beyond the Australian gateway(s) or beyond the foreign gateway(s).

In its submission, Qantas suggests that the code share arrangements support the viability of the Qantas and Air Niugini services on the Brisbane-Port Moresby market and therefore also support the ability of consumers to experience three different on-board products. Based on the trends in seat factors and market shares achieved by the three carriers serving the market in 2017, it is evident that the support the code share services are providing to Qantas and Air Niugini is at the expense of Virgin Australia's commercial performance. If allowed to continue, the code share may limit Virgin Australia's ability to attract sufficient passengers in the market to the extent that our services may not be sustainable. This would see the degree of choice available to consumers on the PNG route reduced, rather than enhanced. The code share services have already had a negative impact on the outcomes for consumers on the Brisbane-Port Moresby market, given the reduction in Virgin Australia's schedule from six to five frequencies per week. In Virgin Australia's view, continued choice of three on-board offerings on the route is likely to be best supported by discontinuation of the code share arrangements.

In relation to the benefits highlighted by Qantas concerning access to its frequent flyer program, Virgin Australia understands that it is possible to earn and redeem Qantas rewards points for travel on flights operated by Air Niugini, even in the absence of code share services between the two carriers.[39] For example, Qantas frequent flyer points can be earned if a passenger travels on an Air Niugini flight between Cairns and Port Moresby, where there is no code sharing in place.

We note that Qantas has not provided any material in its submission as to how its proposal would deliver efficiencies through lower tariffs, provide improved standards of service or stimulate innovation by itself or Air Niugini. Based on industry data, the code share services have not delivered materially lower tariffs by either Qantas or Air Niugini on the Brisbane-Port Moresby market.[40]

Trade Benefits

For trade benefits under paragraph 5.1 (d), 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.

Virgin Australia notes that Air Niugini is the only airline operating wide-bodied B767 aircraft on the PNG route. This provides Air Niugini with a significant competitive advantage in attracting freight business, as the only carrier with the ability to transport palletised and containerised freight on the route. This competitive advantage is likely to deliver freight revenues to Air Niugini which make a strong contribution to the commercial sustainability of its services in the Brisbane-Port Moresby market. In addition, Qantas states in its submission that it obtains a hard

[39] https://www.qantas.com/fflyer/dyn/partners/airline/air-niugini#using-qantas-points.
[40] IATA Direct Data Solutions Ticket Detail report, 12 months ending November 2016 and November 2017.

block of capacity on the B767 services operated by Air Niugini in this market, providing Air Niugini with a guaranteed stream of revenue for these services. As noted above, Air Niugini's freight volumes between Brisbane and Port Moresby increased by 5% between 2016 and 2017. These factors should be taken into account when evaluating claims by Qantas that it is doubtful that Air Niugini would be able to maintain a wide-bodied service on the route absent the code share services. It is quite possible that it is in Air Niugini's commercial interest to maintain wide-bodied services on the route, regardless of whether there is a code share arrangement in place with Qantas.

It may also be the case that any decision by Air Niugini to reduce or withdraw its wide-bodied services from the route would be driven by commercial considerations unrelated to the existence of code share services with Qantas, particularly under a free sale arrangement for passenger services, which does not provide any guaranteed revenue to Air Niugini as the operating carrier. Any unmet demand in the freight market as a result of a reduction or withdrawal in capacity provided by Air Niugini would likely see other carriers look to upgrade their capability to carry cargo on the route (for Australian carriers, 60 tonnes per week of freight capacity remains available for allocation on the route). Both Qantas and Virgin Australia have wide-bodied aircraft in their fleet which could be deployed, Pacific Air Express Australia may increase its dedicated freighter operations and other dedicated freighter airlines may look to enter the route. While Qantas states that narrow-bodied aircraft are limited to carriage of freight with a maximum weight of 32kg per piece, Virgin Australia has the capability to uplift individual items of freight up to a maximum weight of 60kg on our services on the PNG route. [CONFIDENTIAL MATERIAL REDACTED]

While approving the extension of the code share services on the Brisbane-Port Moresby market may provide Air Niugini with another source of revenue to support its B767 operations, this would come at the expense of the commercial performance of Virgin Australia's flights and potentially jeopardise our ability to maintain services on the route in the future. This outcome would not be of benefit to the public, nor consistent with the object of the Act to promote economic efficiency through competition in the provision of international air services.

In its submission, Qantas claims that, "The efficiencies of combined passenger/cargo services are evidenced through more competitive cargo rates for consumers than dedicated cargo providers." It is not possible to assess the validity of this statement as actual rates have not been included in the submission.

Industry Structure

For industry structure under paragraph 5.1 (e), the Commission should assess the extent to which applications will impact positively on the Australian aviation industry.

As outlined above, the commercial performance of Virgin Australia's services to PNG has deteriorated sharply since the introduction of the revised code share arrangements between Qantas and Air Niugini and has led us to reduce our capacity on the route. If the proposed continuation of the code share services on the

Brisbane-Port Moresby market is approved by the Commission, it is unlikely that the commercial performance of our flights will improve and it may become challenging for us to maintain a meaningful presence on the PNG route over time. This would have potentially serious implications for competition on the route, to the detriment of the travelling public and the freight forwarding sector. It would also weaken Virgin Australia's position in the Australian aviation industry.

Recommendations

Based on the material outlined in our submission, it is evident that the parallel code share arrangements in effect between Qantas and Air Niugini on the Brisbane-Port Moresby market have already had a detrimental impact on our services and competition since their implementation. These arrangements have allowed the carriers to concentrate their market power, at the expense of Virgin Australia, the travelling public and Australia's export sector. If allowed to continue, the code share arrangements will inevitably further stifle competition in the market, and may lead to the scenario where the route effectively becomes shared between two carriers in a strong commercial relationship. Without any competitive constraint, it is likely that this would see airfares rise and service options reduced. These outcomes would not be of benefit to the public. Virgin Australia is therefore of the view that in accordance with section 25 (2) of the Act, the Commission should not vary the relevant determinations as requested by Qantas, at least in relation to the Brisbane-Port Moresby market. This is wholly consistent with the fact that up until the Commission's decisions in 2016 on the PNG route, it had never before approved any proposal which would allow two carriers with a dominant position on a route to offer code share services on markets which they operate in parallel with each other.

For the markets between each of Cairns, Sydney and Townsville and Port Moresby, Virgin Australia urges the Commission to exercise caution in assessing the variations requested by Qantas, given that the likely effect of such code share services would be to foreclose these markets from entry by another carrier in the future. If the Commission is inclined to grant approval for Qantas and Air Niugini to code share on these markets, it may be appropriate to impose conditions to ensure that there is a level of competition between the carriers.