

21st August 2006.

Mr Thomas Abe
Commissioner & CEO
The Independent Consumer & Competition Commission
P.O. Box 6398
Boroko...NCD.

Dear Sir,

DRAFT REPORT – REVIEW OF THE PNG AIR TRANSPORT INDUSTRY

Air Niugini Limited (ANG) takes this opportunity to thank ICCC for the review undertaken to improve the Air Transport Industry. Air Niugini's response to the draft report is prepared in two parts. Part One of the response will address the procedural and overall industry issues whilst the Part Two addresses the specific issues raised in the Draft Report.

PART ONE

Procedural objections

ANG objects to the following procedural aspects of the draft report.

1. The terms of reference published in January envisaged that the report would be finalised by 18 August 2006. The ICCC took 5 months to issue its draft report, which raises issues going beyond the original terms of reference, and has requested responses within a month of issue of the draft. This timetable is not realistic.
2. ANG has suffered competitive disadvantage as a result of unauthorised disclosure by the ICCC of information about ANG's fuel purchase prices- see page 47 of the draft report- which information was clearly stated to be confidential: see page 14 of ANG's initial response. This erodes the high level of confidence that ANG has in the ICCC. In order to separate this matter from the process of reviewing the draft report, ANG has instructed its lawyers to raise this breach of confidentiality with the relevant authorities.
3. In general, ANG is concerned that greater emphasis has been placed on submissions made by Airlines of PNG than on those from other industry participants, including ANG.
4. ANG notes the ICCC's comments in relation to code-share agreements. ANG is concerned that some of these comments suggest an assumption by the ICCC that a continuation of ANG's code-share arrangements with Qantas would necessarily require consent of the ICCC in the form of a formal authorisation. With respect, ANG understands it would only require ICCC authorisation to continue its code-share agreement if the agreement were likely to substantially lessen competition. There are a number of reasons why this is not likely, and why the code-share in fact supports, rather than lessens, competition. ANG would be happy to provide further information to the ICCC in this regard. In the

interim, ANG believes it is premature and inappropriate to make statements in a public report that suggest the ICCC has pre-judged this important question.

3. International Comparisons

ANG suggests that the reference "CAA has commented that airfares in PNG are amongst the highest in the Asia Pacific region ... Air Niugini has engaged in selective competitive marketing" not be made in the report. With respect, CAA's functions do not extend to considering pricing or marketing by operators, and ANG considers it would be inappropriate to repeat these comments, which are not correct.

ANG disagrees with the statements on page 28 that the code-share "effectively restricted the competitive tension between Qantas and Air Niugini" and that "there is no immediate evidence to suggest that this arrangement has enhanced competition and contestable pricing behaviour between the two carriers". This issue is discussed in more detail below.

At page 22 of the draft report it stated that the submission of Mr. David Olley compared fare levels between Air Niugini and Jetstar . ANG is disappointed that the draft report, in discussing this submission, failed to provide any discussion on the service level differences between Low Cost Carriers and traditional airlines. In Low Cost Airline typical business model, service they provide significantly vary from the traditional airlines. Instead, the draft report leaves the average reader with the impression that the comparison cited by Mr Olley is fair and typical. In relation to the argument of airfares, ANG has taken the liberty to obtain airfares from various operators on the 20th August 2006 via internet as given below and have analyzed to present a more elaborated response to ICCC's position on this issue.

ANG believes that the ICCC review reflected the lack of industry knowledge on this subject and failed to educate readers of the draft report on the passenger volume, aircraft utilization, operational limits such as daylight operation, operating environment related costs such as staff accommodation, transport, security etc more specific to PNG environment. There was no comparison carried out in fairness to ANG similar environment costs. Airfare comparison to African continent may have been proved a fairer comparison to enable the reader to understand the challenges that Aviation Industry face in Papua New Guinea.

Airfare Information obtained from the Internet and current Air Niugini fares show the following.

Date	Airline	Start	Destination	Distance (Km)	Fare Type	Air Fare	No of Flights	Per Km cost
21/08/2006 (Sch.1)	Virgin Blue	Cairns (One way)	Sydney		1976 Promo	AUD 399.00	4	AUD 0.20
					1976 Flexi Saver	AUD 449.00	4	AUD 0.23
					1976 Fully Flexible	AUD 499.00	4	AUD 0.25
					1976 Corporate	AUD 565.00	4	AUD 0.29
(Sch .2)	Virgin Blue	Sydney	Cairns		1976 Promo	AUD 259.00	4	AUD 0.13
					1976 Promo	AUD 199.00	4	AUD 0.10
					1976 Flexi Saver	AUD 449.00	4	AUD 0.23
					1976 Fully Flexible	AUD 499.00	4	AUD 0.25
					1976 Corporate	AUD 565.00	4	AUD 0.29
21/08/2006 (Sch.3)	Jetstar	Cairns	Sydney		1976 Jetsave	AUD 359.00	1	AUD 0.18
					1976 Jetflexi	AUD 399.00	1	AUD 0.20
(Sch.4)	Jetstar	Sydney	Cairns		1976 Jetsave	AUD 239.00	1	AUD 0.12
					1976 Jetflexi	AUD 399.00	1	AUD 0.20

Date	Airline	Start	Destination	Distance (Km)	Fare Type	Air Fare	No of Flights	Per Km cost
21/08/2006 (Sch.5)	Qantas	Carins	Sydney	1976	Red edeal	n/a	18	
					sup.saver	AUD 396.00	18	AUD 0.20
					sup.saver	AUD 464.00	18	AUD 0.23
					flexi saver	AUD 647.00	18	AUD 0.33
					fully flexi	AUD 765.00	18	AUD 0.39
					fully flexi	AUD 402.00	18	AUD 0.20
					fully flexi	AUD 1,010.00	18	AUD 0.51
(Sch.6)		Sydney	Cairns	1976	Red edeal	AUD 247.00	15	AUD 0.13
					Red edeal	AUD 406.00	15	AUD 0.21
					sup.saver	AUD 321.00	15	AUD 0.16
					sup.saver	AUD 871.00	15	AUD 0.44
					flexi saver	AUD 644.00	15	AUD 0.33
					flexi saver	AUD 95.00	15	AUD 0.05
					fully flexi	AUD 402.00	15	AUD 0.20
					fully flexi	AUD 1,237.00	15	AUD 0.63
					business	AUD 1,168.00	15	AUD 0.59
					business	AUD 1,861.00	15	AUD 0.94
					21/08/2006 (Sch.7)	Virgin Blue	Sydney	Nadi
Flexi Saver	AUD 504.00	2	AUD 0.16					
Fully Flexi	AUD 524.00	2	AUD 0.17					
Corp. Plus	AUD 604.00	2	AUD 0.19					
21/08/2006 (Sch.8)	Qantas	Brisbane	Nadi	2715	Red e	AUD 563.00	2	AUD 0.21
					Red e	AUD 708.00	2	AUD 0.26
					sup. Saver	AUD 407.00	2	AUD 0.15
					sup. Saver	AUD 882.00	2	AUD 0.32
					Flexi Sav	AUD 557.00	2	AUD 0.21
					Flexi Sav	AUD 1,255.00	2	AUD 0.46
21/08/2006 (Sch.9)	Qantas	Brisbane	Singapore	6146	Sale	AUD 1,379.00	1	AUD 0.22
					Red e	AUD 1,420.00	1	AUD 0.23
					sup. Saver	AUD 0.00	1	AUD 0.00
					sup. Saver	AUD 0.00	1	AUD 0.00
					Flexi Sav	AUD 1,068.00	1	AUD 0.17
					Flexi Sav	AUD 3,414.00	1	AUD 0.56
21/08/2006 (Sch.10)	Qantas	Brisbane	Port Moresby	2091	Fully Flexi	AUD 1,198.00	1	AUD 0.57
21/08/2006 (Sch.11)	Qantas	Brisbane	Port Vila	2476	Sup. Sav	AUD 817.00	1	AUD 0.33
					Flexi. Sav.	AUD 840.00	1	AUD 0.34
21/08/2006 (Sch.12)	Qantas	Brisbane	Tokyo	7136	Sup. Sav	n/a	1	
					Flexi. Sav.	AUD 3,888.00	1	AUD 0.54
21/08/2006 (Return Fare & return distance)	Air Niugini	Brisbane	Port Moresby	4182	Spring Sale	AUD 742.49	1	AUD 0.18
					Super Sav.	AUD 821.49	1	AUD 0.20
					Flexi. Sav.	AUD 1,167.49	1	AUD 0.28
					3M Excurtion	AUD 1,497.49	1	AUD 0.36
					sp.J class	AUD 2,321.49	1	AUD 0.56

An analysis of the above airfare information shows the following.

1. Comparison of Brisbane / Port Moresby / Brisbane route fare structure and competitor pricing proves that the perceived opinion of the ICCC draft report that ANG international airfares in the region is 70% more expensive is undoubtedly questionable. ANG requests ICCC to provide information used in the review for ANG's analysis. On the above evidence ANG is of the view that the draft report lacks credibility and creates negativity against ANG in the public domain damaging its reputation, goodwill and attempted to divert customers from using its services.
2. Although ANG provided the route profitability information on its routes which indicates the average fares, ICCC review appears to have failed to analyze the information provided prior to making comments in the draft report. The ICCC never sought any clarification from ANG on the information provided if they had any doubt on any information from ANG.
3. Airfares applied by all airlines vary daily and hourly based on the demand and capacity available. Therefore, Mr. David Olley's comment is not an absolute fact. The rate quoted by Mr. Olley has now changed to the following table below. In the absence of more details such as time of purchase i.e. well in advance purchase or just prior to travel etc. information provided by Mr. Olley cannot be used with credibility. As noted below, even the same route, same carrier return fare is more expensive on today's market. If Mr. Olley's comment is taken as gospel truth, then since the time of his travel, the relevant airline appears to have increased its airfares by 521% in the maximum case to 167% in the lowest case. This further highlights the fact that use of information that enter into public domain must be carefully screened to protect the credibility. ANG request ICCC removes the reference to the information with poor credibility in its final report and provide more credible information in its final report.

Date	Airline	Start	Destination	Distance (Km)	Fare Type	Air Fare	No of Flights	Per Km cost
21/08/2006 (Sch.1)	Virgin Blue	Cairns	Sydney	1976	Promo	AUD 399.00	4	AUD 0.20
					Flexi	AUD 449.00		
					Saver	AUD 499.00		
					Fully Flexible	AUD 565.00		
(Sch .2)	Virgin Blue	Sydney	Cairns	1976	Promo	AUD 259.00	4	AUD 0.13
					Promo Flexi	AUD 199.00		
					Saver	AUD 449.00		
					Fully Flexible	AUD 499.00		
					Corporate	AUD 565.00		
					Corporate	AUD 565.00		

4. Airlines change their airfares based on the capacity and passenger volume. Budget / Low cost airline airfares are generally lower than the traditional airlines. Comparison of Jetstar and Qantas fares prove that even if Jetstar is owned by Qantas, due to different service structures, the airfares applied in both airlines are different.

5. Following from point 4 above, the ICCC draft report did not attempt to distinguish the two types of airlines and their airfare structure, but continued with a direct comparison of submissions by parties with vested interest without proper and independent screening of information. This has substantially deteriorated ANG's confidence in the ICCC to carry out a credible review and with industry knowledge.
6. Between ANG and QF there is price competition to capture customers and the current code-share arrangement has maintained that competition. This is reflected in the price competition between the parties.
7. There was no attempt by ICCC to understand the role of ANG as an airline that has recovered through the "Flight Parth to Recovery". Undoubtedly, ANG has made a significant improvement in its financial and operational performance within the last three years and made the services more reliable and safe. ANG has a reputation for safe operation. This safety record has been achieved by investing substantially on capital expenditure, staff training and systems and processes. ICCC draft report failed to embrace or appreciate the safety record which is fundamental to a successful air service operation.
8. Airfares applied by an airline reflect its operating cost and the environment it operates. ANG operates in an environment where every PNG based pilot and flight attendant is provided with ANG paid accommodation. The annual cost of accommodation alone cost ANG K3 million a year. In addition to this ANG also provide various house hold amenities, water and electricity to their staff. This position is similarly reflected in Engineering and other divisions to retain skilled staff within airline operations at a time when the demand for aviation professionals is very high internationally and domestically. In addition to the provision of above facilities, all engineering, operational and flight operations staff including technical and flight attendant crew are transported to and from their work place at various hours with armed security services as escorts. I am sure that the residents in Port Moresby still remember that several flight crews faced very unfortunate incidents at various times from criminal elements. ANG as the employer has a duty of care to its employees. These services require millions of Kina spent to provide air service to the traveling public. The ICCC draft report failed to recognize and differentiate the operating environment in Australia and other countries to Papua New Guinea. The review appears to have assumed that PNG has a similar working environment to that of Australia and Fiji due to lack of PNG knowledge by the parties who carried out the review. These issues raise a serious doubt on the credibility and knowledge of the people who have carried out this review. ANG reserves it right to refer these issues to appropriate authorities for further review to ensure that ICCC carry out a proper process in its review.
9. ANG has carried out an airfare review in the African continent that reflects a similar working environment to PNG. Please see the table below.

SECTOR		SOM (KM)	MPM	(USD)	Published (USD)		Rate per KM AUD	
				Y	YEE45	YAP2M	Y	Lowest Promo
NBO	HRE	1955	1470	613		723	0.4180	0.3278
NBO	LOS	3829	2852	846	1040		0.2945	0.1810
NBO	DAR	668	500	236			0.4709	
LAD	JNB	2484	1857	505	684		0.2710	0.1835
LUN	DAR	1517	1332	555	594		0.4877	0.2610

The above table, in comparison with the previously provided airfare information, shows ANG airfares rate favorably. The ICCC failed to seek or make similar comparisons in its review.

The draft report also referred to the submissions by the PNG Chamber of Commerce and Industry to suggest that the flight time between Port Moresby and Singapore is three hours. In fact it is six hours. This is a fundamental error of fact which further damages the creditability of the draft report. The ICCC also failed to recognize the type of aircraft used in operation, age of the fleet, volume in the selected route for comparison and capacity available on the route prior to making negative remarks on ANG airfares. This displayed the lack of local and industry knowledge and competence of the parties engaged in the review.

In summary, ANG requests that the ICCC provide credible and sound information that is applicable to the industry in its final report that adds value, aiding the balanced judgment of the average reader.

The airfare charged by an airline is highly linked to the capacity and the passenger volume. ANG takes the liberty to highlight two destinations referred in the ICCC report for comparison.

Brisbane / Auckland Route.

AI	Org	Cp	Dst	Miles	Date	Deps/Week	Seats/Week	ASM/Week
BI	BNE		AKL	1,428	Apr06	3	747	1,066,716
DJ	BNE		AKL	1,428	Apr06	4	544	776,832
EK	BNE		AKL	1,428	Apr06	6	2,604	3,718,512
GA	BNE		AKL	1,428	Apr06	2	586	836,808
NZ	BNE		AKL	1,428	Apr06	20	4,614	6,588,792
QF	BNE		AKL	1,428	Apr06	10	1,957	2,794,596
BI	AKL		BNE	1,428	Apr06	3	747	1,066,716
DJ	AKL		BNE	1,428	Apr06	4	544	776,832
EK	AKL		BNE	1,428	Apr06	7	3,038	4,338,264
GA	AKL		BNE	1,428	Apr06	2	586	836,808
NZ	AKL		BNE	1,428	Apr06	20	4,614	6,588,792
QF	AKL		BNE	1,428	Apr06	10	1,957	2,794,596
TOTAL						91	22,538	32,184,264

Brisbane / Nadi Route

AI	Org	Cp	Dst	Miles	Date	Deps/Week	Seats/Week	ASM/Week
DJ	BNE		NAN	1,689	Apr06	5	680	1,148,520
FJ	BNE		NAN	1,689	Apr06	7	1,270	2,145,030
DJ	NAN		BNE	1,689	Apr06	5	680	1,148,520
FJ	NAN		BNE	1,689	Apr06	7	1,270	2,145,030
TOTAL						24	3,900	6,587,100

Sydney / Nadi Route

AI	Org	Dst	Miles	Date	Depts/Week	Seats/Week	ASM/Week
DJ	SYD	NAN	1,972	Apr06	5	680	1,340,960
FJ	SYD	NAN	1,972	Apr06	7	2,758	5,438,776
DJ	NAN	SYD	1,972	Apr06	5	680	1,340,960
FJ	NAN	SYD	1,972	Apr06	7	2,758	5,438,776
TOTAL					24	6,876	13,559,472

As shown above, PNG volume and capacity of less than 2300 a week is no comparison to the comparative routes discussed in the ICCC draft report. ANG will be willing to provide any further information on other routes to the ICCC if required. The above facts prove that the Port Moresby / Brisbane route is absolutely a thin route for any operator.

5.1 Cost inputs- Fuel

ANG has suffered competitive disadvantage as a result of unauthorised disclosure by the ICCC of information about ANG's fuel purchase prices- see page 47 of the draft report- which information was clearly stated to be confidential: see page 14 of ANG's initial response. This erodes the high level of confidence that ANG has in the ICCC. In order to separate this matter from the process of reviewing the draft report, ANG has instructed its lawyers to raise this breach of confidentiality with the relevant authorities. In any event, ANG requests that the ICCC deletes references to ANG's fuel prices on page 47, given that this information was confidential.

ANG also queries why the ICCC refers to "perceived" higher costs of fuel resulting from the commencement of the Napa Napa oil refinery. In ANG's experience, fuel costs have clearly been higher as a result of the pricing formula under which the industry operates now compared to the previous system. In ANG's submission, there is no public benefit resulting from the pricing formula that has been adopted. Furthermore, Air Niugini has on at least one occasion been forced to ground its aircraft fleet due to the absence of safety certification of fuel sourced from the Napa Napa refinery.

SECTIONS OMITTED DUE TO CONFIDENTIALITY ISSUES

SUBMISSIONS OMITTED DUE TO CONFIDENTIALITY ISSUES

6. Competition issues

ANG notes the ICCC's analysis of the potential competition effects of code-sharing arrangements. In its initial response to the ICCC, ANG did not provide detailed submissions in relation to these issues, as it was not apparent to ANG that this was required and it was not referred to in the issues paper. In view of this, ANG was initially surprised that the draft report deals with the code-share agreement in detail.

Nevertheless, ANG notes and welcomes the Commission's observations that code-sharing has the potential to be pro-competitive, particularly where routes are 'thin' and likely to be marginal for multiple operating carriers. ANG believes it would be appropriate for the ICCC to note explicitly in its report that routes between Australia and PNG are likely to fall into this category.

ANG is puzzled and concerned, however, by statements in the draft report in relation to the form of the code-sharing arrangements between ANG and Qantas. These include the following:

"...some other form of code sharing arrangement could have been used which would have still permitted some degree of competition between the two parties"

and:

"as noted by Airlines PNG, there are various options available that affectively [sic] ensure that there is a level of competition between joint service providers on a code share route"

Such statements suggest that the form of code-share adopted by Qantas and ANG does not promote competition between the parties, or that there are other forms of code-share that are more conducive to such competition. ANG believes that the form of code-share it has adopted does permit competition. The opposite system to this is a "Free Sale" structure, which does not promote as strong competition amongst the parties. Indeed, the structure adopted by ANG / QF is specifically designed to promote competition.

The Commission has noted that Qantas and ANG's code-share arrangements are structured on a "hard block" basis. If the report is to comment on the competition effects of code-sharing, ANG believes it is important that the Commission's report go on to specifically recognise that –

- (a) the 'hard block' structure used by Qantas and ANG means each party must pay for its allocated seats, whether it sells them or not. This creates similar cost incentives (and, therefore, incentives for competition and discounting) to those which would exist if Qantas and Air Niugini each operated their own aircraft on this route; and
- (b) far from restricting competition between the parties, the structure used by Qantas and ANG is the structure recognised and recommended by regulators and commentators around the world as being the most competitive form of code-share available.

By contrast, Airlines PNG's code-share proposals, which are presented in the draft report as being pro-competitive, appear to amount to a proposal requiring competitors to ration supply capacity and allocate that capacity through a formal market sharing arrangement to the highest bidder. Far from facilitating competition, such a proposal would increase regulation, increase prices and would run contrary to the Government's policies of removing barriers to entry and promoting competition in the market for air services.

ANG is also concerned that a number of comments in the draft report suggest an assumption by the ICCC that a continuation of ANG's code-share arrangements with Qantas would necessarily require consent of the ICCC in the form of a formal authorisation application. With respect, ANG submits that authorisation would only be required if the code-share arrangements were likely to substantially lessen competition.

There are a number of reasons why ANG believes this would not be the case. These include the following:

- (a) ANG's code-share arrangements with Qantas enable the use of widebody aircraft on the POM/BNE/POM route. This creates substantial cost efficiencies that would not be attainable in any other way, lowering per passenger costs and enabling the provision of higher quality services than would be viable without code-share support;
- (b) The use of widebody aircraft provides greatly increased freight capacity, increasing competition in the provision of airfreight;
- (c) As noted above, the routes between PNG and Australia are 'thin' and likely to be marginal for multiple operating carriers. Without the purchase of capacity by Qantas, it would not be viable for ANG to offer capacity between Australia and PNG comparable to that currently offered under the code-share arrangements;
- (d) Even with Qantas sales efforts, average load factors on ANG's code-share services between Australia and PNG are low by international standards. Considering the international standards, Qantas may require over 70% load factor for an independently operated service to PNG. Lack of code-share would also remove the ability of ANG to operate a wide-body aircraft in its Asian routes, causing serious consequences to the country and the travelling public.
- (e) The current code-share enables two airlines to sell a full schedule of services in competition with each other. Without a code-share, this would not be possible.

- (f) As noted above, the Qantas and ANG codeshare is structured on a 'hard block' model which creates incentives for each airline to actively compete in the sale of its block of seats.
- (g) Barriers to entry to this route are low. At a regulatory level, prior to the expansion of the code-share to cover the Port Moresby/Brisbane/Sydney route the Air Services Agreement between Australia and Papua New Guinea (and a number of other Pacific region countries) was expanded to provide for:
- Designation of multiple carriers by either country
 - An increase in allowable capacity of passenger and freight services in each direction
 - Contemplation of code sharing, blocked space and any other co-operative service arrangements

A copy of the memorandum of understanding between the parties is attached. In short, the new arrangement implemented full deregulation of PNG- Australia air services, in comparison to the previous arrangement under which only two operators could be designated on each side.

- (h) It is important to note that many countries now include the ability and acceptance of code-share by carriers as part of the Air Service Agreements.

ANG would be happy to provide further information to the ICCC in relation to any of the points raised above. In the interim, ANG believes it is premature and inappropriate to make statements in a public report suggesting the ICCC has pre-judged this important question of whether ANG's code-share arrangements promote or lessen competition.

6.2 Distribution Network

The opening paragraph in the ICCC report itself proves that the writer did not have appropriate industry knowledge or has relied on a submission by an ill informed party on the industry practices on distribution systems.

ANG strongly disputes and challenges the ICCC to prove its stated comments on the operating methodology of distribution network and on the issue of bias by ANG. By the release of draft report with incorrect facts, it has damaged ANG's reputation and goodwill. It is important for the ICCC to note that, whilst it supported the recommendations of Airlines PNG, it reflected bias and the ICCC report fully reflected APNG's views.

ANG wishes to quote the response from SITA network service provider on the comment by the ICCC draft report as "**commercial in confidence**".

SECTIONS OMITTED DUE TO CONFIDENTIALITY ISSUES

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The above response itself is sufficient for the ICCC to draw its own conclusions on the issue. However, as this subject is a very complex one, ANG offers its assistance to meet with ICCC if required to provide further explanations and information for it to accumulate correct and clear knowledge on the subject matter.

ANG further reiterates that ANG's role of training of travel agents as the National Distribution Centre for Gallelio GDS has no involvement at all on its own distribution system. If there is such comment in other submissions ANG invites ICCC for further clarification and discussions with the ANG CEO or his delegate directly to clear the air and doubts for the benefit of the industry and to protect the independence of the ICCC.

ANG further requests that the ICCC remove its comments in this section of the report that are ill informed on the subject matter.

PART TWO

This part of the response will directly deal with the issues individually as referred in the ICCC draft report. Air Niugini Limited (ANG) is disillusioned with the content of the draft report in so much as that, whilst the ICCC purports to be an independent body, the draft report shows an extraordinary amount of criticism of Air Niugini and strong bias towards APNG.

Whilst it is accepted that the role of the ICCC is indeed to foster a competitive environment under which industry in general throughout Papua New Guinea should operate, surely there should be greater recognition of the very different circumstances that apply in PNG versus more developed countries and larger economic bases than exists here. It is also very important to note the economic input of initiatives suggested by the Commission against the Airline which has just recovered from serious financial crisis.

ANG wishes to highlight some of the more contentious points of the report.

Executive Summary

Page 4. Para. 4; Despite the Government's commitment to an 'open skies' policy, the report concludes that there has been a decline in demand for air transport due, at least in part, to the increasing cost of air transport. In an 'open skies' environment, one would expect the reverse to have applied which should demand the question of why there should be a decline in the number of aircraft registered in PNG and why an increasing cost of air transport exists. ANG contends that much of the reason is that airline operators are increasingly operating in a higher cost environment caused by inefficiencies in the aviation related activities in PNG, such as air navigation facilities, airport infrastructure, etc. The other major reason is the extraordinary increases in the costs of fuel. The report failed to identify the input of these issues on airfares and quantify the same.

Last Para.; Special discounts and other incentives have been available for tourist groups for a very long time and have come in many different forms eg. Nett fares, group discounts, tour conductors free tickets, carriage of sporting equipment free of charge, discounted domestic add-ons, etc.

The statement that 'it has been in response to new competition entering the market, causing the incumbent operator to take action' is false and can readily be demonstrated to be so. Further, Air Niugini Board and Management have been working closely over a long period to deliver airfares reduction. The Board and management also have been working on methods to reduce excess capacity and filling more seats with fare initiatives. The action by Air Niugini on Airfares is a direct result of these reviews. It is important to note that Air Niugini initiated its new airfares well before APNG announced their decision to enter the market with 737-200 [**SECTIONS OMITTED DUE TO CONFIDENTIALITY ISSUES**]. It is equally important point to reflect the Commission's bias to APNG and missed the date order of events prior to making such negative remarks in the report on airfares introduced by ANG.

Page 5. Air Transport Sector in PNG; There are three carriers providing international services to/from PNG – ANG, APNG, and Qantas. Not two as stated. QRA has also applied to operate services between CNS and POM.

ANG's B767 aircraft is leased from AWAS with the maintenance contracted to Air New Zealand. The information in the report is totally incorrect.

Last Para.; The paper contends that the average fare into/out of PNG is 70% higher than comparable international fares elsewhere. How has the ICCC determined what is an average fare? Using the graph on page 27 where it asserts that ANG obtains an "average" K1.00 per kilometre, one can deduce from this that ANG's "average" fare Port Moresby to Brisbane is K2091 for the journey one way, when in fact ANG's [**SECTIONS OMITTED DUE TO CONFIDENTIALITY ISSUES**]. This converts to K0.49 per kilometre and in itself destroys the credibility of the paper's analysis. Route profitability and passenger information were provided to the Commission "Commercial In-Confidence" basis. However, the analysis has ignored or chosen not to use the information provided. Clearly the paper fails to demonstrate how it has determined so-called "average" fares. Indeed, has it even compared like airfares? The full normal economy class one-way tariff published fare from Port Moresby to Brisbane is K1922. Less than 20% of total travellers travel at the full economy fares, so how can we have an "average" above this figure? The majority of travellers purchase special or promotional fares which are substantially less than the normal full economy class fare.

ANG requests an explanation from the ICCC on how it has determined the “average” fares for each carrier stipulated. It would appear that the paper has indulged in selective pricing to portray a pre-determined outcome which happens to be unfavourable to Air Niugini.

Page 6. First Para.; The paper makes the outrageous assertion that Fiji is PNG’s direct competitor in terms of tourism expenditure. What does this mean? Fiji has in excess of 15,000 bed nights available daily year round, primarily for tourists. PNG would have less than 1,500 and more than 50% of these would be primarily allocated for business traffic. Fiji has a well developed and mature tourism culture which has involved over more than 40 years of cultivation and recognition that tourism plays a major part in the prosperity of the Country’s economy. Annually, Fiji has over 500,000 tourists, some 480,000 more than the officially agreed number of tourists to PNG. Nadi is serviced by more than 1500 international aircraft seats per day.

These volumes for Fiji create economies of scale which in turn provide a capability to provide lower airfares. Such volumes do not exist on the Aust/PNG routes, which by any standard can only be described as a ‘thin’ route for traffic.

The statement that ‘this conclusion is supported by the recent response by ANG to APNG’s decision.....’ is factually incorrect and should be retracted. Air Niugini wishes to register its strongest objection to this assertion. ANG released its “SuperSaver” fares on 23 June 2006, before any advice from APNG that they were to commence services from Brisbane to Port Moresby. ANG’s decision to launch the “supersaver” fares was driven by a desire to stimulate tourism traffic between Australia and PNG and to address the excess capacity issues that the Board and the Management have been working on for some time. APNG’s initial announcement of 737 aircraft took place in PNG on 25 July 2006. Clearly, Air Niugini’s actions cannot be seen as a response to APNG. Further, the services provided by APNG with a 32 year old aircraft cannot be compared to the wide bodied aircraft service provided by Air Niugini. Subsequent to this on 31 July, ANG released a comprehensive revised package of airfares between Australia and PNG which reflects a strategy to simplify our pricing on the international network, modernise the terms and conditions attached to the fares, and to make the pricing more customer friendly overall. This will proceed with or without APNG.

Page 6. Para 2 Infrastructure; The paper seems almost dismissive of claims by the Airlines that airport and aviation infrastructure and facilities contribute to overall inefficiencies and as a result, the operating costs of airlines in PNG. Issues such as being able only to operate to most ports during daylight hours adds enormously to the costs of operations, and does not permit fleet productivity optimization.

Given the ICCC statements in this paragraph, where is the business case for upgrading provincial airports like Gurney, Rabaul, etc to international capability when they are currently barely fit for domestic use?

Page 9. Fuel; It is interesting to note that, in a paper promoting competition in the aviation sector, competition as it relates to fuel appears to be dissipating with Mobil gone, Shell going, leaving only InterOil as a monopoly supplier. Apart from cost, just as critical are some of the supply issues and reliability of supply. GKA, GUR, MDU, TIZ, WBM, CMU, VAI, PNP and MAS have all had supplies of aviation fuel withdrawn, whilst there has been erratic supply at WWK, KVG, BUA, LNV, and HGU.

The above, when combined with the deterioration in navigation aids and scaling back of Air Traffic Control / weather reporting services, means that costs for airlines are significantly impacted and potential payloads are penalised by the necessity to carry more fuel from the origin departure point than would be necessary if fuel was available

at the destination airport. This issue was in the public domain and widely reported when the Islands region ran out of stock of jet fuel.

Page 10. CAA; Most of CAA's budget goes in salaries, leaving little money for airport and infrastructure maintenance and improvement. Even POM is very deficient in many areas and a list of deficiencies compiled by ANG and given to CAA has now been outstanding for two years. Tarmac line marking (or lack of) and potholing have now become serious issues, to name just two items. This does not mean the CAA is not attempting to fix the issues but lack financial and other resources.

Page 12. Codesharing; By world standards, the PNG/Australia route can only be described as "thin".

The paper acknowledges that various options exist that may ensure there is competition between codeshare partners. The option of seat purchase under a 'hard block' facility is generally seen as the most competitive of these options and this is the option used by PX/QF on the codeshare routes.

Air Niugini assert that APNG, in its recommendation, indirectly supports the code share without fully understanding the operational aspects of it.

Page 12 – Marketing; The aviation industry is going through various industry initiatives. In this regard, particularly with IATA members, e-ticketing is a major industry initiative. PX is progressively implementing this globally endorsed initiative and required time to select its reservation system prior to engaging on an internet booking engine. ANG has a major e-Commerce project underway which will see such a facility being available before the end of year 2006. SITA has been contracted to provide this facility for ANG and the product is in line with global standards for such booking engines. The APNG booking facility cited by the ICCC is a very basic system and is currently limited to its small international point to point routes between Pt Moresby and Cairns and Brisbane. Such basic products are not suitable to handle the complex fare structure and network at Air Niugini. It may be worth the ICCC noting that many of the world's major airlines, including Singapore Airlines, Thai International, and others have only been able to provide sufficiently sophisticated systems to cater to their complex international networks within the last 12 months. There are numerous other major airlines who have not done so as yet. ANG decided that if the airline was to progress this initiative, then it would implement a system that would serve the airline and its customers in a professional manner.

Internet booking engines have a very small penetration for airline bookings for medium and long haul international journeys, necessitate major overhauls to airline pricing models, are usually more effective on pure point to point one way sectors, etc. Traditionally, international fares adopted by the world's major airlines through the IATA pricing mechanisms under Tariff Coordination and Interlining Resolutions have penalised point to point one way traffic, and rewarded return journeys with more complex itineraries. Though there are signs that this model is now breaking down, it still is significantly in the majority of fares sold.

The Global Distribution Systems (GDS) providers such as Galileo, Amadeus, & Sabre still service the vast majority of airline's bookings via travel agents worldwide. Low cost airlines whose business models showed disregard for the GDSs are now finding they need to embrace the strengths of these GDS's. Virgin Blue has signed arrangements with a GDS for the management of its commercial drive to secure more of the corporate market.

The GDS facility is available to all airlines who are prepared to pay the applicable GDS fees. Most scheduled carriers choose to do so and include GDS bookings as a vital

part of their overall distribution strategy. APNG has chosen not to make GDS bookings available for their international sectors. This has nothing to do with ANG or the agents. There are strict protocols that apply through the GDS bookings that provide for fair display of participating carriers flights and services. ANG has no control over this aspect – contrary to the assertion by APNG & ICCC .

ANG uses SITA Gabriel as its CRS booking platform. The system used by the small number of accredited travel agents in PNG is Galileo and ANG acts as the National Distribution Centre (NDC) for Galileo, as it was the only operator equipped to do so. As part of this contract it requires that ANG provides travel agent training. Galileo and SITA Gabriel are separate systems.

SITA's role in the market both in PNG and globally is that of an IT&T company specializing in solutions for the Air Transport Industry (ATI). They provide solutions across the entire ATI horizontal with the clear exception of Global Distribution Services (GDS). In PNG we supply "in-house" solutions to Air Niugini, Airlines of PNG and the Port Moresby Airport Authority - none of these solutions extend to travel agents.

GDS companies such as Galileo generate their revenues by distributing airline and travel products to travel agents via booking systems which are deployed in travel agent offices. Each time a travel agent completes a booking transaction on a GDS booking system, the associated airline or travel vendor is charged a (distribution) transaction fee.

ANG does not understand how its role can “limit the effectiveness of the market in allowing new competitors to emerge”. Such a statement is uninformed, cannot be demonstrated to be true, and smacks of bias against ANG and displayed incompetence in the part of the ICCC team on industry knowledge.

SECTIONS OMITTED DUE TO CONFIDENTIALITY ISSUES

ANG would be interested to learn more about the proposed ‘one-stop’ distribution network that meets the needs of IATA member airlines and tourism value chain. Air Niugini suggests prior to the review, members for the inquiry to acquire industry knowledge for the delivery of fair judgement on the issues.

Page 20 Services; Air Niugini now services Hong Kong in addition to the other ports mentioned and plans further expansions to Fiji before year end.

It should also be noted that Queensland Regional Airlines (QRA) has applied to the Australian International Air Services Commission (IASC) for permission to operate 6 x DHC-8 services per week between Cairns and Port Moresby. This will bring four carriers on the Cairns route.

Page 21. Legislative Environment; In addition to the legislative circumstances stated, Air Niugini, as an International Air Transport Association (IATA) Airline Member, undertakes to meet IATA requirements and recommendations and operates to International Civil Aviation Organisation (ICAO) standards. In meeting these requirements, recommendations, and standards, ANG chooses to meet the global best practices and to remain part of the major airlines’ community which continues to

provide interline services for seamless travel to and from all points worldwide, ultimately providing the travelling customer with a user friendly experience.

Membership of IATA comes at a cost and this is so for ANG meeting IATA's "Simplifying the Business" projects which includes the adoption of e-ticketing worldwide by the end of 2007, removing paper tickets altogether; the adoption of Common-User Self Service Check-in at airports; Bar Coded Boarding Passes; Radio-Frequency ID for baggage tags; and Paperless cargo. ANG's investment in these projects will be enormous and all in the interests of providing a better product to our customers.

APNG, as a non-IATA airline, appears to have foregone the adoption of some of the recommended standards. The form of e-ticketing they have adopted does not lend itself to interlining at the IATA standard and they appear to have chosen to isolate themselves from the broader international airline community. This applies to their election to provide only an internet booking option for the international sectors rather than the more expansive GDS facility primarily used by travel agents.

Page 22. Submissions; ANG does not place much credibility in the anecdotal information provided. Basic laws of supply and demand apply and comparing Jetstar with Qantas (Jetstar's parent company) over the same Sydney/Cairns routing may well have exposed as big anomaly as that with the Port Moresby / Cairns comparison chosen. ANG has had an AUD470 return fare available from Cairns to Port Moresby for some time but Mr Olley has obviously chosen to ignore this point, as has the ICCC. Equally Mr Olley overlooks that on Jetstar flights, there is a range of fares and at the high end with more flexible terms and conditions, SYD/CNS sells for AUD399. Jetstar's parent company Qantas, a full service carrier like ANG, for its more flexible fare in economy class from SYD to CNS charges AUD765.00 one way, a point again missed by Mr Olley and the ICCC.

ANG asserts that again the paper dabbles in selective outcomes to support preconceived ideas, which are easily discredited. Air Niugini notes the lack of industry knowledge by many parties.

The PNG Chamber of Commerce has also chosen to relate information of little or no consequence. Firstly the ANG flight from Port Moresby to Singapore is of 6.5 hours duration, not 3 hours as stated in the paper. The cheapest return published fare from POM to SIN is currently K2968, not around K4000 as stated.

ANG is interested to note the comments from the CAA. What evidence was provided by CAA to support its statement that airfares in PNG are among the highest in the Asia Pacific region and more importantly, we assume that CAA can evidence their preposterous claim that ANG has engaged in selective competitive marketing on specific routes to ensure it maintains a monopoly on such routes? This statement cannot go unchallenged and calls upon the CAA to provide evidence to support the claim. ANG offers discounted promotional fares on all routes.

Page 22 Discussion; Correction – APNG operates six services per week between CNS and POM, and as previously stated QRA has applied to operate a further 6 services per week.

The paper states the codeshare agreement with Qantas impacts on price competition between Qantas and ANG, yet it provides no evidence to support this claim. Whilst it can be said that the two airlines have offered similar fares between Australia and PNG resulting in many instances from one carrier matching the other's initiatives as they have been released, each carrier manages its own inventory as it sees fit.

Whilst ANG may have closed out sales of its lower fares, Qantas may still have seats available at these rates and vice-versa. This constitutes competition in every sense. Similarly, ANG released a new Aust/PNG fares package on 31 July including a discounted business class fare. Qantas would appear to have chosen not to match some of the fares, including not offering the discounted business class product.

The paper further states on Page 23 that “ANG’s dominance has translated into higher prices and lower levels of service”, yet again it provides no examples or specifics of this being the case. Surely such a claim must be supported with evidence. It is also negative of a valuable public asset.

Page 23. Para.1; ANG agrees with the assessment that the PNG aviation industry is small in world terms and this result in relatively high average costs and therefore it is important to choose appropriate airlines for comparison of airfares. Yet this paper has chosen to compare with Jetstar, Virgin Blue, and other low cost airlines operating on high demand, high volume routes. Perhaps the ICCC could explain this significant contradiction. Further, the ICCC has failed to understand the difference between traditional airlines such as Qantas, Air Pacific and Air Niugini from Low Cost Carriers such as Jetstar, Virgin Blue etc. This involves selective negative reporting, and misleading the public intentionally or through lack of industry knowledge with the Commissioner for the Inquiry. Air Niugini reserve its rights to refer the issue to relevant authorities.

Additional to the special circumstances which can impact on the meaningfulness of fare comparisons, ANG wishes to add other factors such as law and order, security costs, interest rates, staff accommodation costs, high cost of skilled labour, fuel and CAA monopolies, lack of generally accepted infrastructure such as national highways, public transport, etc.

As a result, ANG questions the choice of Australia, Malaysia, Thailand, and New Zealand as “similar” markets to assess the performance of the PNG industry. On what basis are these countries similar to PNG? In Air Niugini’s own review and comparison of airfares with African operation with similar issues stated above, Air Niugini airfares fared favourably. Further, the Carriers who provide services to such countries seem to charge airfares similar to Air Niugini. Please see the table below for details.

FARES COMPARISON

BSR	16 August 2006
1usd =	3.04971

SECTOR		SOM (KM)	Normal (USD)	Lowest Published (USD)		Rate per KM (USD)		Rate per KM (PGK)	
			Y	YEE45	YAP 2M	Y	Lowest Promo	Y	Lowest Promo
NBO	HRE	1955	613		723	0.3136	0.2459	0.9563	0.7500
NBO	LOS	3829	846	1040		0.2209	0.1358	0.6738	0.4142
NBO	DAR	668	236			0.3533		1.0774	
LAD	JNB	2484	505	684		0.2033	0.1377	0.6200	0.4199
LUN	DAR	1517	555	594		0.3659	0.1958	1.1157	0.5971

SECTOR		SOM (KM)	Normal (PGK)	Super Saver (PGK)			Rate per KM (PGK)	
			Y	TSAVER			Y	TSAVER
POM	BNE	2091	1922	925			0.9192	0.2212
POM	CNS	843	1158	595			1.3737	0.3529

Page 23 Domestic Fares; Though in the interests of consistency, ANG still is not aware of how the Paper has determined “average” fares for its comparisons, it is pleasing to note that PNG domestic fares are comparable with those elsewhere. It can be said that once you compare the thin volumes experienced in PNG with the heavy volumes elsewhere ie. SYD/MEL, then PNG domestic fares offers extraordinary good value. It is disappointing to note that the ICCC has chosen not to report the fact of cheaper domestic special fares such as the Wantok, Weekender, and Nambawan fares in a more positive manner and provide ANG with some credit for such initiative.

Page 24. Significant discounting also occurs in the PNG market, not dissimilar to that which applies overseas. ANG provides its overseas General Sales Agents with nett fares, fully inclusive holiday fares, group fares, and special add-ons for domestic arrangements. ANG has a yield and capacity management system Pros II which is a sophisticated system used by many of the world’s major airlines including Singapore Airlines, Cathay Pacific and Air New Zealand. ANG is perplexed by the statement that the PNG market is lagging behind in terms of a sophisticated approach to yield management. It is not fair on Air Niugini and not correct for the Commission to assume such assertion and release the report for public comments.

ANG does concede that sophisticated yield management systems realise their full value when market circumstances dictate that supply and demand for seats are well matched. A 60% load factor is low by industry standards and therefore there is every incentive to try to create additional demand. Notwithstanding this, active yield management still takes place at ANG.

Page 25. Graph Average Price per Km – Domestic; ANG notes that among the higher range kina/kilometre rates, there is a preponderance of APNG sectors where they enjoy a monopoly. The fact that APNG airfares are high on sectors that Air Niugini does not fly has received no appropriate comments from ICCC. PX believes this as bias towards APNG.

Page 26. International Fares; ANG views that it can be safely said that the information stated in the Paper is discredited from the outset. The Paper’s failure to specify how “average” fares have been calculated and those comparisons have been done using equal parameters dictates it be discredited.

ANG wishes to highlight some of the inaccuracies and contradictions:

- The Paper persists in making meaningless comparisons, and not like with like. Virgin Blue is a low cost carrier. PER/SIN is a relatively high demand/high volume route as is Australia/Nadi.
- Aust/Fiji route is dominated by FJ/QF operating under a codeshare arrangement, yet the paper acknowledges it is significantly cheaper. This has been the case well before Pacific Blue commenced flying to Fiji, and simply reflects the higher demand that exists over the routes.
- ANG would dearly wish to operate more than one B767 equivalent type aircraft, yet the overall demand does not justify it at this time or in the past.
- If, as the Paper states, the lack of competition allows ANG to charge higher, less competitive fares, then it must equally be said that such an environment should encourage competitors to enter the market. Most airlines would jump at the opportunity to ply their trade over high yielding routes, providing those airlines can see sufficient demand to do so.
One presumes such airlines have not seen that the demand exists, because it is a fact that ANG has not stopped any Airline from competing on its routes.
- As ANG can demonstrate that its average fares and kina per kilometre rates are substantially less than those shown in the Paper, comparison with other sectors is rendered meaningless.

- The APNG Discovery fare equates to K0.81/km which is approximately the same as the K0.79/km achieves for its average fare on the POM/CNS route.
- The average fare per kilometre POM/CNS is in fact substantially higher than longer haul international services such as POM/BNE – not lower as stated in the Paper.
- ANG's POM/BNE average fare and cost per KM is much less than the above as disclosed by ANG in its initial submission to ICCC as Commercial in Confidence. ANG encourages the ICCC to pursue the information provided by ANG in this regard and welcome any clarification from ICCC.

Page 28; The Paper asserts that the codeshare agreement effectively restricted the competitive tension between Qantas and ANG. ANG contends that it allowed two airlines to survive on the route as without the agreement, ANG would not have continued its operations and as displayed earlier in the report, Air Niugini may have been closed down.

ANG has always provided tourist fares between Australia and PNG and very cost effective as well. Prior to the recently announced SuperSaver fares, ANG actively promoted BNE/POM return for AUD599 for a considerable time. This was primarily aimed at the tourism market. The SuperSaver fare has further reduced this to AUD499 excluding taxes and surcharges. Additionally, ANG provided tour wholesaler fares at levels less than the AUD599 return fare, including a free domestic sector.

Page 29; The statement which refers to infrequently available “wantok” fares is incorrect unless ICCC considers the more than 36000 people who have purchased the wantok fares for the YTD to be insignificant and infrequent in availability. The ‘wantok’ fare takes up almost 15% of total domestic inventory. When combined with other discounted promotional fares, more than 35% of ANG’s customers travel at substantially discounted fares domestically, thus making no sense of the Commission’s assertion that ANG has relatively low use of discounting and yield management. We consider this as a deliberate effort to discredit Air Niugini and being bias towards APNG.

ANG disputes that load factors on individual routes are extremely high. The stated load factor of 58% is extremely low, giving ANG every incentive to stimulate demand.

The Paper states ‘the high prices charged by ANG.....’ as an accepted fact. ANG does not accept this to be true, and further claims this to be further evidence of the Commission’s preconceived conclusions on this matter.

It is worth noting that in many instances, costs of land arrangements in PNG can be considered to be significantly higher than ‘competing’ destinations, with many accommodation/resort establishments attracting high room prices without providing true value for money.

Additionally, there is the high cost and inconvenience of visas for PNG which further acts as a disincentive for prospective tourists.

Page 29. Summary Observations; In view of the evidence presented in this response from ANG, the statement that PNG performs poorly against the international benchmarks is clearly erroneous and should be retracted, as should the suggestion that ANG applies discounts only on some routes. ANG offers discounts on ALL routes over which it operates.

ANG regrets the Commission’s inference throughout the Paper that the codeshare between ANG and Qantas provides little or no evidence of competition and implies anti-competitive behaviour by the two airlines. It is interesting to note that since

commencement of the codeshare arrangement, APNG has entered the market and QRA has sought permission to enter. Air Niugini welcomes the competition to deliver a better value to customers.

Whilst the Commission notes that ANG has an ability to discriminate between international and domestic travellers in terms of its pricing potentially giving it a competitive advantage in the domestic market, any inference that it cross subsidizes its domestic operations from its international operations would be false and misleading. ANG again states for the record that its domestic network operations are self-sustaining independently to international operation. ANG request the ICCC to provide the evidence to support its view that ANG cross subsidizes.

Page 32. Para 1. Infrastructure;

- Continuous interruptions due to power blackouts, unavailability of navigational aids and consistent maintenance and upkeep of airports has had major adverse impact on Air Niugini.
- This has led to Air Niugini's name and reputation being tarnished as it is the perception of the traveling public that anything that happens in an adverse way at the airport is the responsibility of no one else but Air Niugini.
- Additional costs have been incurred by Air Niugini especially when flights have been cancelled for operating aircraft downgrades– F100 to F28, F28 to DHC-8, due to the forgoing. Costs have been mainly incurred for hotel accommodation, meals, aircraft charters and other service recovery actions.

Page 33. Para 3.

- As it is at the moment, most airports in the country do not even meet minimum standards.
- To this end, the comment 'fit for purpose' is far from reality based on the current state of most airports.
- In ANG's view, the main airport in the country, Jacksons Airport in Port Moresby, does not meet international standards.
- All in all, this has a major impact on Air Niugini and other potential carriers wanting to operate into PNG.
- The use of Nadzab airport in ANG's view is again another clear case of the country building an airport to cater for future business growth, but unfortunately it has not been supported by Government infrastructure – law and order, navigational equipment maintenance, building and providing for services that will call for international services – CIQ.

Page 35. Last Para.

- Use of Sixth Freedom flights is already in place – SIN/POM/BNE, SIN/POM/HIR, MNL/POM/BNE, HIR/POM/SIN.
- The transit time at POM is between 2 to 3 hours.
- The downside to this is that there are no proper facilities at the departure hall to make their waiting time pleasant – coffee shop, news agency shop, internet facilities – user pay etc.
- In this regard, other carriers would possibly reconsider using POM as a hub if the facilities at Port Moresby International airport were comparable to other international airport standards.

Page 36. Para 3.

- CAA's inability to manage airports at most airports results in individual airlines having to meet such costs.
- The claim by CAA that it is not able to recover the full cost of service provisions is far from the fact as in many cases the services are available but at a very

minimum. A typical example in Air Niugini's case is where we are meeting the cost of security at airports.

Page 37. Para.2/3.

ANG notes that it is vital that all airports meet minimum requirements set out including operational navigation aids and tower controls. Clearly they don't with recent inoperative nav aids being experienced at BUA, HKN, RAB, WWK, & LAE, and extended power outages at POM and HKN.

Page 40. Para 2.

- Changing the ownership of airport management, preferably to the Provincial Government or a private ownership in ANG's view is the way to go for the future. A typical example is taken from the case of Tokua Airport. It will place the onus on respective Provincial Authorities to ensure that their airports are kept in a state where flights in and out of these locations will be regular as well as providing for the movement of goods and services including business opportunities – tourism etc.
- As the local authorities are on the ground, ANG feels that they will be impelled to take corrective actions where necessary. Right now CAA is not meeting this requirement adequately – hence the adverse impact on airline operators and the traveling public.
- CAA being the regulator as well as manager of airports in my view as it is at present is not proper from a good governance point of view.
- On other hand, ANG maintains that CAA maintains the regulatory responsibility.

Page 44. Para 2. Safety & Security

- Security is a major concern at all airports, including the major airport at Port Moresby – International and Domestic.
- The preference by CAA to maintain responsibility for security and safety at regional airports is noted. However, it is sad to say that it is not being carried out properly.
- Air Niugini has a long list of outstanding issues with CAA in Port Moresby dating back to 2001 on issues relating to safety and security. Very minimal progress has been made to address these issues.

Page 45, Last Para

- Should it be considered that the Commission is not very keen to see night flying in PNG.
- Night flying in PNG has wider implications – law and order especially.

Page 48. Fuel; The Paper states that ANG has adopted the fuel surcharge rates applied by Qantas to avoid any price differential between the two airlines, particularly given the codeshare arrangements. The fact is that ANG wants to be competitive with Qantas and others, and therefore ANG cannot afford to charge more. This itself proves the point that, although it is a code share, PX has to be competitive and market forces ultimately determine price.

Page 64. Codeshare; Codesharing is an established and accepted method of providing, air services globally, and especially in the Pacific region. The Pacific Island countries aviation services are largely made up of long “thin” routes which are difficult to support with relatively large aircraft, and smaller aircraft do not provide the necessary range. Some carriers which have folded or experienced viability difficulties include Air Nauru, Polynesian, and Royal Tongan. Examples of code-shares in the region are:

1. Air Pacific/Qantas	- Fiji/Australia	All flights operated by Air Pacific [FJ]
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2. Air Vanuatu/Qantas	- Vanuatu/Australia	All flights operated by Air Vanuatu [NF]
3. Air Tahiti Nui/ Qantas	- Tahiti/Australia	All flights operated by Air Tahiti [TN]
4. Air Calin/Qantas	- New Caledonia/Aust	Both carriers operate.
5. Japan Airlines/Qantas	- Japan/Australia	QF ops CNS, JL/QF SYD, BNE
6. Qantas/South African	- Aust/Sth Africa	QF ops SYD, SA ops PER
7. Qantas/British Airways	- Australia/UK	Both carriers operate.

In addition to the above, a number of Pacific carriers codeshare with each other eg. Air Pacific and Air Vanuatu. Similar codeshare arrangements are now very common in not only in thin routes, but also in high volume routes in Europe and USA.

Some of the above code-shares arguably provide less incentive for competition than the PX/QF, since they are all “freesale” code-shares rather than “blocked space”. Therefore there is less incentive for the marketing carrier to sell seats as there are no upfront costs which it needs to recover. However, PX/QF have adjusted “Block code share” which promotes competition between parties to sell their blocked seats.

There is no evidence that these code-shares to Fiji and Vanuatu have created a barrier to new entrants. Pacific Blue has entered the markets in a significant way, well after the code-shares were established. ANG contends that the commencement of APNG to CNS, apparently successfully, and now to BNE, and the possible emergence of QRA to POM from CNS is further evidence that competition and codesharing can co-exist on the PNG routes.

Page 65. Submissions; ANG maintains that the codeshare agreement with Qantas is positive for ANG, for PNG, and for customers on the PNG/Australia routes and for travel to/from other destinations. Without the codeshare, neither ANG, nor any other PNG operator, would be able to sustain widebody aircraft operations. Currently, there is insufficient passenger demand on the routes to the north to warrant additional flying of a wide-bodied aircraft, and the existing flying would be in itself insufficient to justify the retention of the B767 aircraft. Additionally, there would be serious implications for the carriage of freight to/from PNG. With narrow-bodied aircraft, freight carrying opportunity can be reduced by as much as 95% versus wide-bodied B767 type operations. This has been discussed in a separate paper.

As stated earlier in this response to the Commission, the Paper states the codeshare agreement with Qantas impacts on price competition between Qantas and ANG, yet it provides no evidence to support this claim. Whilst it can be said that the two airlines have offered similar fares between Australia and PNG resulting in many instances from one carrier competitively matching the other’s initiatives as they have been released, each carrier manages its own inventory as it sees fit. Whilst ANG may have closed out sales of its lower fares, Qantas may still have seats available at these rates and vice-versa. This constitutes competition in every sense. Coincidentally, ANG released a new Aust/PNG fares package on 31 July including a discounted business class fare. Qantas would appear to have chosen not to match some, but not all, of the fares, including not offering the discounted business class product.

Page 65. Discussion; There can be no doubt that the PNG / Australia routes can be categorised as “thin” routes by world standards, and though it is arguable whether it is commercially sustainable for multiple carriers to operate services, the bilateral Air Services Agreement between Australia and PNG provides for multiple designation of carriers from both sides to operate services. Previous to the current ASA, the agreement provided for two airlines from each country to operate services.

Thus it is very clear that there has been no regulatory impediment that has stopped any airline from operating, and it must be made very clear that ANG has not impeded any new carrier entering the market at any time.

Para 2. It is interesting to note how intently the Commission has listened to Airlines PNG who obviously have no great experience in codeshare operations. ANG will be interested to hear of practical options available that ensure greater levels of competition between the codeshare partners than the hard block option conducted by QF & PX.

Para 3. The codeshare has not prevented new entrants into the market and new competition eg. APNG (CNS and now BNE) and maybe QRA as well on CNS.

Page 67. Distribution Network; The assertions and submissions made by APNG in this context are completely fictitious and malicious, either displaying a fundamental ignorance of the GDS's and their global role in the travel industry, or it is intended to cover the fundamental weakness of the APNG business model which chooses to deal direct with the customer bypassing the travel agency network electing not to pay commissions at the same time, not embracing the GDS's presumably to save on their considerable participation & transaction fees.

Submissions. To create such an 'NFP' entity providing a common platform for customer relationship systems and booking systems would firstly entail an enormous initial investment, and to think any company will fund this without expecting a return on their investment would be uncommercial. The GDS's are perhaps closest to providing such services and the NFP competing with the GDSs does not bear thinking about. Why reinvent the wheel?

Discussion. The inference that ANG has abused its role as the National Distribution Coordinator for the Galileo system is insulting and is outright rejected. The GDS's adopt strict protocols that govern the displays used in booking tickets and provided the airline contracts to pay the GDS fees and transaction charges, then that airline will be given fair and equal display and access to the agent's booking priorities and preferences. When asked for comment on the Paper in relation to this matter, the head of one of the larger travel agency outlets responded as follows:

"What a load of rubbish obviously an extreme bias towards Airlines of PNG in all of this. I find it a joke to suggest that Galileo as maintained by PX, is biased to advantage that carrier and this acts as a barrier to entry for new carriers!!"

The only barrier is that certain airlines are not prepared to pay the joining costs and other associated costs that all other carriers (worldwide) presently involved in Galileo are paying. These so called disadvantaged airlines want the worldwide exposure that Galileo offers but are not prepared to pay the entry fees set by the GDS.

It is agreed that Air Niugini has played a significant role in training and equipping agents, though over the last few years agents have purchased their own equipment apart from itinerary and ticket printers. To suggest that Air Niugini, by doing the training for Galileo is influencing Agents to book the dominant carrier is unprofessional. Never in the 13 years in travel industry has Air Niugini been influenced to book in a Galileo training environment."

Whilst ANG acknowledges the increased levels of bookings via the internet, and as previously stated ANG is progressing its e-commerce aspirations through the implementation of a globally accepted internet booking engine facility, unlike the basic system adopted by APNG, ANG still believes that the GDS's will continue to provide the majority of airline bookings for many years to come. It is important to note that

even with the E-Commerce environment, the GDS's still carry their role in reservation. Though it is a wrong belief that GDS's will disappear with the introduction of E-commerce. This may be true to small or budget carriers, but not to major airlines with interline arrangements.

Page 68. Monopoly Service provision on Some Routes; ANG recognises the various constraints that apply in relation to the carriage of freight. In this regard, ANG has already investigated and actions are place to purchase a dedicated freighter to service its domestic operations.

The submissions and discussion that follows in 6.3 is rather academic and appears to have been heavily influenced by APNG's own agenda. ANG's domestic route structure has maintained consistency over many years. Claims of ANG 'cherry picking' the more profitable routes are baseless and do not deserve further comment other than to say APNG seems to endorse competition when it suits them, but not when it means a challenge to their own over-priced monopoly service operations.

Air Niugini operates its domestic network under a 'hub and spoke' model, and ANG disputes that it has significantly changed its fleet configuration in the past decade or more. Such assertions as recorded on page 72 need correction. ANG does operate a number of unprofitable domestic routes.

ANG rejects claims of 'cherry picking' more profitable routes and demands evidence to support such claims with evidence. Otherwise it requests the Commission to retract these statements.

Page 72 Structure of the CAA. ANG is of the view that the CAA should ideally be restructured and the roles of Safety Authority & Regulator be separated from its current operational roles.

Wasantha Kumarasiri
Chief Executive Officer
Air Niugini Limited

Encl: Schedule 1-12
 Attachment A

Attachment A.

Air Niugini Cargo Report for ICC

Attached is a detailed report since from 2003 until July 2006 showing cargo weight and revenue (including the Qantas code-share) uplifted over all the international sectors operated by the B767 (Table 1). Table 2 shows a summary of cargo revenue and weight uplifted for both B767 and F100 on international sectors alone.

Cargo uplifted throughout the network on the B767 is 95% where the F100/F28 loads represent 5% of the companies total weight carried since 2003.

High demand sectors for Air Niugini is the Brisbane to Port Moresby sector where under the code-share agreement load factor is close to 90%, however on the Port Moresby to Brisbane sector the load factor is around 30%. Cargo to and from Australia is very much directional with cargo that does travel on the Port Moresby to Brisbane sector is predominately bound for the Japan market consisting of tuna fish.

There have been two attempts since 2003 of cargo charter operators to accommodate the tuna fish into the Japanese market. The first attempt was with Pacific Air Express (PAE), which operated an AN12 from Brisbane to Lae and return on a weekly basis. This was initiated by Maps Tuna with Neptune Fisheries having some space on the service and both companies based in Lae. After several attempts the service failed as the cost become exorbitant with no regular cargo load from Brisbane to Lae to offset cost.

The second attempt was when Sanko Bussan and CT Freight negotiated a deal with Heavylift Cargo Airlines to operate a charter from Cairns to Port Moresby return. The charter service was then approved to operate as a regular weekly service to operate Cairns/Lae/Port Moresby/Cairns by Department of Transport. Conditions on the approval were no cargo was permitted between Lae and Port Moresby and it was to operate twice a week. The operator did not maintain the submitted schedule and chose to operate when they had cargo loads. In the end the operator and CT freight had to cancel the service as the pricing for the tuna exporters once again was exorbitant and unsustainable to maintain the exports.

As described above the main problem is that support for a weekly charter service is unachievable compared with a daily service Air Niugini operates. Most shippers/clients chose not to use this service as it was unreliable and did not want to sacrifice the current allocation on Air Niugini in case the cargo charter did not operate. In relation to cargo support from Port Moresby to Australia this is seen to be very little in regard to weight as Papua New Guinea main export by air is seafood for Japan and South East Asia. The current yield for this export can not justify an operator to run a daily freight operation between Papua New Guinea and Australia.

It must be made very clear that the cargo movement in and out of Papua New Guinea is very much directional and with having a wide body service does allow the carrier to satisfy the obligations on the passenger and cargo market combined.

Air Niugini over the past four years has developed a close working relationship with all shippers and clients in Papua New Guinea to help support the local markets for those who are now entering the export arena. Likewise we are working closely with the Mining industry to facilitate the movement of heavy equipment on the wide body services from Australia, America and Europe. Both Oil Search and Lihir Gold Limited are two such companies with use the services of the wide body from Australia connecting to the Air Niugini cargo aircraft to their respective ports.

Of recent we have seen a large increase in the movement of mining equipment from Brisbane and Singapore to Port Moresby which again in the long term supports the economic growth of this country.

In closing, the wide body services operated by Air Niugini does have a great impact to the sustainable growth of this country and without this type of service, the country as a whole will suffer major losses in development and see rising cost for imported consumables to support the community just to name two. Information below is **Commercial in Confidence.**

SECTIONS OMITTED DUE TO CONFIDENTIALITY ISSUES

INDEPENDENT CONSUMER & COMPETITION COMMISSION
AIR NIUGINI LTD'S SUBMISSION IN RELATION
TO
DRAFT REPORT OF THE PNG AIR TRANSPORT INDUSTRY

Air Niugini Ltd (ANG) has received the Draft Report of the ICCC in relation to the PNG Air Transport Industry. Air Niugini will respond to the draft report with particular reference to:

1. The national development context within which the airline operates.
2. The principles of competition policy both national and international and how they apply to the aviation industry in PNG in general and ANG in particular.
3. The international and national regulatory regimes that currently operate and have an impact on ANG.
4. The operational and financial issues associated with the PNG aviation industry that influence or impact upon the industry and ANG in particular.
5. Factual matters that arise within the ICCC Draft Report.
6. Recommendations.

DRAFT

RESPONSE BY AIR NIUGINI LTD

To

DRAFT REPORT OF

INDEPENDENT CONSUMER & COMPETITION COMMISSION

REVIEW OF THE PNG THE DRAFT REPORT OF THE PNG AIR TRANSPORT INDUSTRY

18TH JULY 2006

Air Niugini Ltd is a company incorporated under the Companies Act of PNG and is a wholly owned government business enterprise. All the shares are held by the IPBC on behalf of the Government of Papua New Guinea.

Originally, following independence the airline was established as the National Airline Commission. It took over the operations of Australian based airlines that operated in the country at the time.

The Airline is a critical part of the services infrastructure of Papua New Guinea and along with its competitors operates to cities and towns including those that cannot be quickly or easily reached by road or sea.

The financial performance of the Airline since its establishment has been volatile and on several occasions it has had to rely on the support of the Government of PNG to remain solvent and operational. The most recent experience was four years ago when the airline was on the brink of insolvency and a Government guarantee was required to support the Company's borrowing from the Bank of South Pacific Ltd. That guarantee has been expunged and the companies foreign and national debt repaid.

In the context of the international aviation business the Airline's experiences are not unusual. Over the last decade at least three major U.S. airlines were in Chapter 11 bankruptcy; three major European, government owned airlines, Olympic (Greece), Alitalia (Italy) and Sabena (Belgium) were either insolvent or relied almost entirely on government funding and other protective measures to remain operational. In Australia the second largest airline, Ansett Airlines Ltd went into liquidation and a new start up airline Compass Airlines Ltd also collapsed. In New Zealand, in the aftermath of the Ansett Airlines collapse, the New Zealand Government had to inject

\$NZ 800 million to keep Air New Zealand flying. Its profitability has subsequently been re-established. (I do not believe this para is required if preceding is modified)

The purpose of this preamble is to reinforce the fact that owning and operating an airline is a very high risk business with the potential for external factors beyond the Airline's control to cause revenue and earnings after tax to fluctuate and for costs to rise suddenly and dramatically. Examples of the former are the impact of the SARS virus outbreak in the Asian region and the most recent impact of bomb threats on trans-Atlantic and European flights. An example of the latter is the 100% plus increase in the price of aviation fuel over the last 12 months. All these external factors are and over which individual airlines have no control.

In countries such as PNG the risk profile is increased due to:-

- (i) The geography and climate of the country which can often conversely affect schedules and load factors,
- (ii) The continuing inadequacy of airports and the implementation and administration of the regulatory regimes,
- (iii) The expectation of governments and the community at large that Air Niugini (because it is government owned) and to a lesser extent, its private sector competitors have a community service obligation especially in the provision of domestic services and to a lesser extent in the provision of international services, and
- (iv) The statutory and other obligations it has to meet because it is a government owned business enterprise e.g. appearances before the Public Accounts Committee and the maintenance of higher cost employment practices.

In its draft report the ICCC has recognised some of these factors. However, in the case of Air Niugini Ltd it has not examined or explored whether the return on shareholders' funds meets the benchmarks for the aviation industry and the impact of the Airline having considerably higher levels of accountability than its private sector competitors e.g. being required to appear before the Parliamentary Public Accounts Committee and having mandatory audit of its annual financial statements by the Auditor-General.

As a government business enterprise, Air Niugini Ltd fully understands the need for the public accountability and in recent years has strived to dramatically improve that accountability. While it has received legal advice that it is not required to appear before the Public Accounts Committee it has agreed to do so as a means of demonstrating its commitment to levels of disclosure that are consistent with best international practice for listed public companies.

However, in terms of one of the major criteria of competition policy competitive neutrality Air Niugini is required to disclose commercial information (which in some cases is commercially sensitive and could be valuable to competitors). In stark contrast its competitors, Airlines of PNG and Airlink as private and unlisted companies, have no such requirement. In fact it is doubtful if either airline has filed audited annual reports for the latest financial reporting period and certainly they are not required to appear before the Public Accounts Committee.

In addition, because it is a government owned airline there are pressures exerted on it in relation to its operations and employment arrangements that are not imposed on or expected of any of its competitors.

The ICCC report has referred to the advantages that Air Niugini has as the largest and incumbent PNG registered airline but does not appear to have taken account of the disadvantages that flow from its ownership.

There is a reference in the ICCC report on investment needs (pps 6-7) but it relates overwhelmingly to the CAA of PNG and airport and associated facilities. However, in addition for any commercial airline to remain operational and profitable there is also a continuing demand for new capital investment in aircraft, supporting spare parts and the infrastructure that enables an airline to meet its safety and security obligations as well as meeting market demands. There is also a continuing demand on the international sector of the business to continually upgrade its software systems to be able to meet passenger booking and freight forwarding requirements, payments and the other services related to an international operation. Although Papua New Guinea is a developing country many of the systems that are put in place are dominated by the demands of major airlines from high volume passenger and freight traffic countries which in the main are the advanced western economies such as the USA and Europe. Airlines in countries such as PNG are expected to

either meet the demands in their own right or hang off a major international airline such as Qantas or Singapore Airlines. E-ticketing is such an effort that the industry is moving towards which requires investment.

In responding to the report, Air Niugini wishes to deal with it under the following headings.

1. The National Development Context:

Throughout the report the ICCC recognises the national development roles played by the aviation sector.

However, in approaching its business the Airline must take an overwhelmingly commercial approach to avoid having to rely on government financial support and become a drain on Consolidated Revenue. Air Niugini notes that where national carriers have become instruments of government policy they have drawn on substantial taxpayer funds and ultimately have gone out of business or been privatised e.g. Sabena, Olympic Airways and Lufthansa. Thus while accepting a government owned airline can make a contribution to national development it should not be at a cost to the taxpayer. In this context it is essential that in its long term interests and those of the country's development it must assess its priorities and the commercial risks associated with them.

In the view of Air Niugini the risks fall into four main categories. These categories are listed in order of significance i.e. if one or more fails it could close down either all the airlines or an individual airline.

- (i) airports and related operational and safety facilities and services,
- (ii) financial position of the aviation sector as a whole and individual airlines and airline services providers e.g. fuel suppliers,
- (iii) government's policies, and
- (iv) Continuing private sector investment .

In the terms of reference for the ICCC's review items 1(a); 1(b); 1(c) and 1(e) deal with the matters (i) – (iv) listed above..

In its comments on the operating environment (pps 20, 31-34, 36-45) the ICCC deals with the issues of infrastructure.

There is no discussion in the report on the need for continuing private sector investment in aircraft types that are commercially suitable to PNG. For example there is a demand in PNG for the use of jet aircraft with seating capacity of between 70-110 passengers. The Fokker aircraft which have been eminently suitable to this role are no longer in production and the availability of high quality second hand aircraft is diminishing. The turbo prop aircraft such as the Bombardier DHC-8 (Dash 8) meet some of the requirements and the smaller end of the Boeing and Airbus range are too large. There is a Brazilian aircraft company, Embraer producing suitable replacements for the Fokker 100 and Fokker F28-4000 but no second hand market has been established as yet for the Embraer aircraft. The cost of buying or leasing new aircraft would require a very substantial increase in airfares to justify their purchase or lease.

Port Moresby International and Lae airports are currently the only two PNG airports that are capable of taking either Boeing B737 or Airbus A320 and the potential loads from to and from other airports would not justify aircraft of this size.

In addition any new aircraft types to be placed on the PNG register require a substantial investment in spares provisioning, staff training (particularly pilots and engineers) and meeting the PNG regulatory requirements. The estimated total direct and indirect costs of introducing a new aircraft type such as a B737 onto the PNG register is about K2-3 million. In terms of competition policy this cost could be regarded as a barrier to entry for a PNG airline.

It needs to be pointed out that a foreign registered airline flying to and in PNG is not faced with these costs although there are CAA PNG limitations on the period of time a foreign registered aircraft can operate to Port Moresby or domestically. It is also important to note if such foreign registered aircraft flying assist training of citizen staff in their skills and Nation building, a responsibility that Air Niugini has undertaken.

In terms of critical factors what needs to be made abundantly clear is that for an international and domestic airline such as Air Niugini with obligations under IATA and ICAO as well as having to meet conditions imposed by the Civil Aviation Safety Authority of Australia in relation to its aircraft, pilots, servicing

facilities and standards, the inability or unwillingness of CAA PNG to meet the minimum standards required by the international regulators can close down **all** the operations of Air Niugini. The same situation will apply to Airlines of PNG and any other operator that flies commercially to or through Australia or to any other country with a similar regulatory regime to Australia.

It is a condition of the code share arrangements with Qantas that the operational aspects and airports which a code share flight operates to and from **must** meet Qantas's safety and security standards. Similar conditions would apply to any other internationally code shared airline such as Virgin Blue (Australia), Air New Zealand(NZ), Air Pacific(Fiji) or Singapore Airlines (Singapore).

Safety and security are what might be described as 'drop dead' issues in terms of compliance.

From October 2002 to April 2003 Air Niugini was under threat from the Australian regulators in relation to the safety and security arrangements in PNG. There was a real threat of an imminent 'cease flying' situation. Had there not been intervention at the most senior Australian and PNG governments' levels Air Niugini (and any other internationally accredited PNG airline operating at the time) could have had its services grounded until the Australian requirements were met. The threat was real and the commercial impact on Air Niugini and any other PNG airline operating Australia would have been disastrous. As it was the CASA only extended Air Niugini's AOC for 90 days until further audits and compliance work were undertaken by CAA PNG.

Under the IATA rules and as a matter of commercial prudence, Air Niugini Ltd is comprehensively insured. A condition of all the insurance policies in relation to aircraft, airline staff and passengers is that the airline and the facilities it uses meet all the regulatory safety and security requirements.

It should be noted by the ICCC in terms of meeting the 'competitive neutrality' criteria of competition policy, Air Niugini is the only PNG registered airline accredited by IATA. Airlines registered in PNG but who are not accredited have a cost advantage. This is dealt with later in this submission.

If any PNG airline is to make a contribution to the development of the tourist sector in PNG as well as facilitating travel to and from and within the country for business and investment purposes there are preconditions that are required:-

- (i) the airline or airlines should be accredited to meet the regulatory requirements of the PNG Civil Aviation legislation (which in turn must meet the standards set down by ICAO) and extraterritorial regulatory bodies such as CASA,
- (ii) the airline or airlines must be able to meet all insurance requirements for passengers and freight,
- (iii) the safety and security procedures of the PNG registered airline or airlines must meet the requirements of international airlines that book passengers on PNG airlines after they transfer from other airlines. For example Singapore Airlines' passengers travelling from Frankfurt to Port Moresby via Singapore who would travel the first sector on Singapore Airlines and the second sector on Air Niugini. There will be a single ticket issued for the entirety of the travel. To make an interline ticket, both airlines must be IATA accredited and have the IATA settlement arrangements.
- (iv) there must be certainty and continuity of schedules as well as commercial support services, and
- (v) passengers and freight forwarders must be satisfied that the infrastructure that supports the airlines' operations meet acceptable international standards.

While a small segment of travellers can be regarded as 'adventurers' prepared to accept higher than normal risks, the vast majority of business and tourist travellers demand safety, security and certainty. This is increasingly the case at a time when the level of terrorist threats has increased.

In addition an airline that did not fully insure or is uninsured would leave itself exposed to very substantial damages claims in the event of an accident where a passenger is killed or injured.

While the Qantas code share agreement will be dealt with in another part of the response, its existence indicates to passengers on the Sydney and Brisbane to Port Moresby and Cairns to Port Moresby services, that the aircraft used by Air Niugini meets Qantas's very high safety and operational standards. The assurance

is regularly verified because Qantas undertakes regular audits of Air Niugini and the airports to and from which the code share flights operate. Age of the aircraft is highly linked to its performance and safety. It is also important to note that more newer and younger the aircraft lease or purchase cost will increase. This in turn is translated to the airfare charged.

As with the code share agreement, the issue of airfares will also be dealt with later in this response. However, from the point of view of the majority of business travellers (private and public sector) non price factors are as important as the cost of airfares. In this respect the business class airfares charged by Air Niugini compare favourably with the range of business class fares charged in Australia and New Zealand and within the region.

In relation to business investment in PNG, Air Niugini submits that it is issues such as the perception of security, law and order, the availability and reliability of supporting infrastructure such as electricity, roads, public services and the commercial returns on investment that will be the main determinates of new investment in PNG and not the cost of airfares.

From Air Niugini's and the aviation sector's, view the critical factor is the lack of investment in airports and associated services and the consistently poor management of the CAA PNG. The Draft ICCC Report suggests some opportunities for improvement.

As will be discussed in more detail, Air Niugini's view is that action is urgently needed to rectify the problems at Port Moresby International Airport and the other major airports (Lae, Madang, Wewak, Gurney, Tokua and Kavieng). Until such action is taken there will be continuing reluctance by the tourist and other industry sectors to make substantial infrastructure investments and tourists will be reluctant to select PNG as a tourist destination.

In summary, Air Niugini agrees with the ICCC's observation (at page 4) that "the mobility of people, goods and information is a vital prerequisite and building block for economic development".

Air Niugini agrees that the PNG Government's policy of an 'open skies' is the correct one both in terms of national economic development generally and

competition policy specifically. It allows entry of a new operator who sees commercial opportunities in PNG and as such, maintains the prospect of additional competition for Air Niugini (and the other airlines). Air Niugini submits that so long as the safety and security requirements are met and an airline demonstrates that it can honour its ticket and freight carriage obligations entry should be allowed. The market should then be the determinate of the airfares and schedules.

In conjunction with the Pacific Islands Air Services Agreement it should also allow Air Niugini and other PNG registered airlines that meet the international regulatory requirements to compete in all the regional markets whose countries are signatories to the PIASA agreement e.g. Australia and New Zealand.

It should be noted by the ICCC that as a consequence of improved operating results in 2005, the airline raised with the Government commencing the payment of dividends or the investment of part of its profits (after providing for asset renewal) in the purchase of airport facilities. Although such action has implications for competition policy in the PNG situation so long as there is a well understood and consistent access regime applied and administered it could help overcome the funding problems of the CAA PNG.

Such an approach amounts to hypothecation of revenue to which the Department of Treasury may raise objections. However, in the light of the parlous state of PNG's airport assets and associated facilities it may be a sensible approach as the airlines have a strong commercial incentive to ensure that the airports are kept operational and meet all the regulatory requirements. Over the last decade Air Niugini has been meeting airport and related security costs that should have been met by CAA PNG. At the same time the smaller airlines have had what can be regarded in competition policy terms as 'free carry' for services and facilities paid for by ANG. Unlike Air Niugini Limited whose profits are known and whose accounts are open to public scrutiny those of the smaller airlines are not and it would be necessary to either gain access to their accounts or arbitrarily determine a level of charges. Another option would be for the government to treat the airports as 'regulated assets' and have the ICCC regularly review the financial performance of the airports and set the charges.

There are two risks in this approach unless all airlines contribute to the costs of maintaining the airports. The first is that of 'free carry' and the second is that of 'game keeper and poacher'.

In relation to the tourist sector Air Niugini submits growth of the overall business and discretionary travel market should be a key objective of the National and Provincial governments and the existing tourist PNG sector. Airfares (plus taxes and charges) are one part of the total cost for both business and tourist travellers but in many cases they are not the major cost.

Air Niugini agrees that there has to be greater effective cooperation between airlines and hotels/tourist operators in terms of both the prices and logistics. One of the reasons for the success of Fiji, New Caledonia and Vanuatu is the ready availability of competitive, combined air travel and accommodation packages. This has been the result of decades of co-operative action between the airlines, hotels and tours operators and governments. That degree of cooperation has not been consistently forthcoming in PNG and there is anecdotal evidence of existing tourist operators resisting such cooperation because they are fearful of losing market share rather than contributing to growing the tourist market.

SECTION OMITTED DUE TO CONFIDENTIALITY ISSUES

Also after protracted and frustrating negotiations between Air Niugini and the CAA PNG and Australian authorities, Air Niugini was able to introduce three jet flights direct between Rabaul and Cairns to meet the requirements of the international tourist ship operator, Orion Cruises. Orion Cruises is a boutique cruise liner market catering to the high income traveller interested in the unusual. It is trying to develop regular tourist liner visits in the region and is the class of tourism that will bring investment with it.

In a similar vein, CAA PNG prevaricated for over nine months about allowing the introduction of an Air Niugini service between Tokua and Honiara and return.

These are specific examples of where **new** services with an obvious positive impact on tourism and investment have been delayed by various challenges and negotiations.

It is a strong recommendation of Air Niugini to the ICCC that if national development is to be a goal of the aviation sector it should be mandatory for the CAA PNG and other PNG authorities to fast tract approvals and for specific times to be set and observed for granting approvals and enabling asset upgrades where required.

If the airlines are able to respond promptly on a commercial basis further investment is likely to follow.

Air Niugini recognises that the PNG Government has limited financial resources and all avenues should be used that encourage private investment in infrastructure.

The Airline has also noted the ICCC's comments about the impact of the Napa Napa oil refinery and the additional costs of supplying jet fuel and the non availability of Avgas.

It is not for the Airline to comment on the appropriateness or otherwise of the decision to grant InterOil what amounts for an exclusive dealing arrangement under which users pay higher prices (even allowing for the recent international oil price increases). The only comment in relation to price is that if the aviation sector is able to secure aviation fuel from other sources at a lower price serious consideration needs to be given to either allowing importation of the cheaper aviation fuel (especially as aviation fuel is a small component only of Inter Oil's production) or a clearly identified surcharge being added to domestic airfares to cover the additional cost.

Alternatively, the government could open negotiations with InterOil to adjust the price of Aviation jet fuel to international parity prices that existed at the airports subject to movement in Crude Oil prices.

The declining availability of AVGAS and the state of many smaller local airports is of major concern to Air Niugini (and probably more so to Airlines of PNG and Airlink) because the smaller, local airports are an essential component in the development of 'hub and spoke' networks for air services. There is no real alternative to the existing light aircraft that service many of the small airports in the Provinces and which in turn supply passengers to the larger airlines operating nationally and internationally.

The smaller airlines also fulfil a significant community role in giving local inhabitants access to health services.

Telecommunications is the other area that impacts significantly on Air Niugini's operations (as with any other PNG airline). Increasingly business is done over the Internet and the introduction of E-ticketing and electronic payments depend upon an efficient and competitively priced international telecommunications system. Air safety is also dependent on a fully operational telecommunications system.

On at least one occasion Air Niugini has been forced to use aircraft High Frequency radio systems to secure aircraft clearance because the PNG telephone system was inoperative !

Currently the services provided by Telikom PNG are neither efficient nor competitively priced. To enable the air traffic control and safety and security systems to work as well as to provide the level of services for tourists and PNG citizens wanting to use E-tickets etc there will need to be a dramatic improvement in the level of telecommunications.

2. The principles of national and international competition policy and how they apply to the aviation industry in PNG and ANG in particular:

The objectives of competition policy are to:-

- (i) provide consumers with a choice of goods and services,
- (ii) ensure prices of the goods and services are determined by an open, transparent market process that enables consumers to make a choice based on comparing like with like,
- (iii) provide consumers with the best quality at the lowest price
- (iv) facilitate ease of entry for new operators, and

- (v) ensure active competition between service providers.

As pointed out earlier in this response, the international airline industry over the last decade has produced uneven results with several U.S.A. airlines being in Chapter 11 administration, Ansett Airlines of Australia collapsing and Air New Zealand requiring a government capital injection for \$NZ 800 million.

In a developing country such as PNG with a very wide range of disposable income - subsistence farming and fishing to a small segment of the population with high levels comparable with developed countries, using normal indicators of affordability, operation of an open market, freedom of choice etc that are essential ingredients of a competitive market system has analytical problems.

An example is that relating to the choice of aircraft type and air fares. If GDP or disposable income figures are used as a basis for assessing the levels of service and prices then PNG's aviation sector should at best be a series of limited turbo-prop services.

However, there is a very strong demand for jet aircraft services internally e.g. between Port Moresby and the ports of Lae, Madang, Wewak and Rabaul with consistent pressure for a permanent jet service to Gurney. While the Airlines of PNG service from Port Moresby to Cairns and return appears to receive some customer acceptance the preference is clearly for the faster jet services. Therefore, in comparing airfares, it must be done in accordance with the types of aircraft used as well.

In view of the PNG government's 'open skies' policy it is also significant that no Australian or New Zealand airlines are operating to PNG either in their own right or on a code share basis. Ozjet, Virgin Blue, Alliance and Air New Zealand all have the aircraft types to operate a service and any one of the three could propose a code share arrangement to either Airlines of PNG or Airlink.

On the freight side of the business Hevi- Lift based at Cairns operated a seasonal freight service with turbo-prop aircraft into Port Moresby and Lae but the services appear to have failed to attract sufficient continuing business and has since terminated.

In terms of choice the range of aircraft types, classes of travel, ranges of fares and terms and conditions of travel is consistent with routes outside PNG between major capital cities and between capital cities and regional centres. For example first class travel within Australia and N.Z is no longer available and the predominance of travel between Australia and N.Z. is economy and business class travel with the latter declining following the introduction of low fare minimum service airlines e.g. Jet Star and Freedom Air.

Virgin Blue and Virgin Pacific as the second major Australian carrier and a relatively new entrant to the Oceania region offers economy class only with no in cabin service included in the air fares.

In all cases the cheaper the fares the less the services and the more restrictive are the terms and conditions of travel at the extreme end absolutely no change in flights and total loss of the fare and charges if a passenger fails to travel.

The success of these low cost services depends on very high volumes, minimal cabin services, rapid turn around times at arrival and departure airports, very flexible employment conditions and the highest possible level of aircraft utilisation consistent with safety and engineering requirements.

ANG on its international routes provides both business and economy class travel with a wide range of discounted fares. On the domestic routes it provides business class service on the F100 aircraft.

ANG's competitors offer only economy class fares with a range of concessional fares. Domestically and in Cairns route these services are not Jet services. As a comparison, jet aircraft consume more fuel and generally a turboprop aircraft uses only around 40% of jet aircraft fuel consumption.

ANG faces a conundrum with air fare policy as the incumbent, dominant PNG registered airline. Its fares act as an effective 'floor price' for the smaller airlines and on domestic routes where there is competition competitors will pitch all or some of their fares just below the ANG fare. Thus to some degree the current ANG fares give competitors a degree of certainty about price

setting, margins etc. It could be argued in terms of competition policy that ANG fares provide a 'floor price'.

On the other hand if ANG starts to aggressively price into a particular market or into the markets generally it will be accused by its competitors of predatory pricing aimed at reinforcing its market position.

This situation is not uncommon around the world and in some instances governments have responded by trying to fix airfares – both for political and quasi-commercial reasons (ironically usually to protect the government owned airline). For many reasons government price fixing of international and domestic airfares has not been successful. In most cases it has been counterproductive because the fares have been kept at artificially low levels and the airline involved has usually gone into bankruptcy e.g. Alitalia, Olympic Airways and Sabena. As a means of avoiding government determined prices airlines have resorted to increasing fees and charges for auxiliary services.

The ICCC drew the comparison with airfares to Fiji from Australia and New Zealand. ANG submits that any comparison with Air Pacific and its services to and from Nadi need to be qualified. The following are the reasons:-

- i. The routes ex Sydney and Auckland are very high volume using Boeing B747-400, B767-300 and B737-800 aircraft,
- ii. All the airports they operate from (except Sydney) operate 24 hours a day and in the case of Sydney it operates from 06hr00 to 11hr00 which contrasts with Port Moresby and other PNG airports that basically have daylight operation only, (This is not correct)
- iii. These destinations do not have the Law & Order issues restricting their operations to limited number of hours in the night,
- iv. Infrastructure in these destinations (road, taxis, hotel accommodation, telecommunication, public and other forms of transport) are in a much higher standards than in PNG destinations,

- v. Nadi is a hub to other Pacific islands for the services arriving from Los Angeles and the Fiji Islands,
- vi. Qantas is a substantial shareholder in Air Pacific and is able to provide a wide range of advice and assistance to the airline(including distribution support services).In addition Qantas also code shares with Air Pacific on flights to Fiji,
- vii. The relationships between Air Pacific, the hotel and tour operators and the government is vastly superior to that between the tourist and aviation sectors in PNG,
- viii. Air Pacific does not have domestic routes as a substantial part of its business and consequently does not have the geographical problems or the community service element in its services, and
- ix. In spite of the intermittent coups in Fiji the actual and perceived security risk is considerably lower than in PNG.

Similarly in making comparisons with Australian and New Zealand operators it needs to be remembered that the volumes of passengers and under aircraft freight are considerably higher than on PNG domestic routes. With the exception of Sydney all major Australian and domestic airports are able to operate 24hrs a day with some exceptions.

A similar situation exists in New Zealand with the exception being Wellington that has similar curfew arrangements to Sydney.

The ICCC report referred to the opportunities on international routes that arise from Air Niugini's sixth freedom traffic rights. Initially, the sixth freedom traffic was valuable – especially between Japan and Australia, Manila and Australia and to a lesser extent between Australia and Singapore.

The value of sixth freedom traffic has diminished considerably. In the first instance a Qantas offshoot ,Australian Airlines started economy class only flights to Japan from Cairns and the Gold Coast. The fares were very competitively priced and

more importantly for passengers did not involve a stopover – such as is the case with services to and from Japan via Port Moresby. Unlike stopover ports such as Changi (Singapore), Dubai and Hong Kong Jacksons Airport is not an attractive stopover airport and offers transit passengers a minimum of facilities.

Subsequent to Australian Airlines low cost travel in the region other airlines such as Singapore Airlines offered highly competitive economy class airfares to Singapore. Qantas increased the frequency of its flights to and from Manila and priced its special economy class fares at levels below Air Niugini's sixth freedom fares to and from Australia to Manila.

The recent decision by Jet Star to enter the regional markets and for Qantas to code share with them such as on services from Eastern Australian capital cities to Asia will further reduce the amount of sixth freedom traffic.

Air Niugini in conjunction with the PNG government has been actively pursuing the opening of a new route from Port Moresby to Nadi via Honiara. In addition to providing a sixth freedom route to India that allows Fijian and other citizens to avoid what they see as less desirable treatment by Australian immigration it will also be marketed as a 'round the world service' that introduces to European and North America passengers some of the outstanding attractions of Oceania including PNG.

In the short to medium term Air Niugini does not assess sixth freedom traffic as likely to increase. On the contrary with the expansion of low cost airlines in the region such as Jetstar, Virgin Blue Pacific and Freedom Air (NZ) it is more likely that sixth freedom traffic and yields will fall.

The international air passenger market is highly competitive both in terms of fares and services. While demand for business class travel is price inelastic mainly because of its very nature economy class travel is to a large degree discretionary and is price elastic.

Air Niugini is very conscious that internationally and to a degree domestically it is competing in a highly competitive tourist market and that both fares in their own right and as part of total tourist packages will influence decisions about tourist destinations.

It is for that reason Air Niugini introduced a range of special fares to match that competition predominantly from international tourist destinations such as Fiji. However, the fare structure and the after tax yields have to earn the Airline a profit so that it can reinvest in the business. Air Niugini's history has been that it ran at a loss and as at 31st December 2003 the Airline's accumulated losses had reached K160 million. It had used an increasing amount of both very short term credit and medium to long term debt to fund its operations. With the preceding fare and cost structure the Airline was not viable and could not have continued its operations.

3.The International and national regulatory regimes that currently operate and have an impact on ANG.

Because of the risks associated with operating aircraft, international organisations whose operations are reinforced by government treaties and protocols, regulate the safety and commercial conduct of airlines around the world.

The two major organisations are the International Civil Aviation Organisation (ICAO) and the International Air Transport Association (IATA). The former deals with safety and security and the latter with commercial conduct.

ICAO is recognised as the core of the international air safety rules and national legislation governing air safety derive from the ICAO rules or protocols. PNG is one of the 189 contracting states to ICAO. While there are variations between countries to suit particular conditions in the application of the protocols, the ICAO rules and protocols are regarded and the 'Bible' of air safety.

With the increasing volume and intensity of civil aviation, the ICAO rules and adherence to them is a fundamental element of any commercial airline operation. Regularly, CAA PNG has not maintained its safety and security standards at the levels required by ICAO and the PNG Civil Aviation legislation that embodies many of the ICAO protocols. As indicated earlier in this submission on numerous occasions Air Niugini has had to undertake the work that should have been completed or consistently undertaken by the CAA PNG. (Is this pertinent to the ICCC report)

In addition to the costs imposed it presents both the Airline and CAA PNG with serious competition policy issues. Because CAA PNG is both the regulator and the asset owner for Air Niugini(or any other airline) to fund and undertake work that should be done by the CAA PNG creates a classic ‘game keeper - poacher’ conflict and in the case of safety and security can raise doubts about the integrity of the regulatory system.

It is Air Niugini’s strong view that these situations should be avoided. While understanding the financial and other restraints facing the PNG government the potential for the ‘game keeper – poacher’ to prejudice air safety and security could be overcome by separating the asset owner from the regulator. The separation needs to be real and not notional if the regulatory system is to have any integrity (which is of particular importance for international airlines) – thus creating an internalized separation within the current CAA PNG is **not** a solution.

It is the Airline’s view that if the PNG Civil Aviation legislation is to have any integrity it is essential that the relevant authorities should act on proposals that have been with it for over two years to separate the asset owning and the regulatory functions of the CAA PNG (Is all this about CAA PNG necessary).

In addition and in terms of competition policy, the ICAO accreditation **with effectively implemented national regulatory regimes** gives passengers an assurance that they are travelling on a safe airline. Air Niugini’s accident record is very favourable and ranks with major airline operators in the region – in spite of the difficult flying conditions for domestic services. An effective regulatory regime that is well administered consistently over a long time period is also an inducement to new airlines wishing to enter the country.

Because it is externally imposed and the rules and regulations apply across the board to all airlines it is Air Niugini’s view that ICAO’s rules and protocols do not constitute a restraint on trade or impediment to entry. On the contrary, as pointed out in the preceding paragraph a well administered regulatory regime and supporting safety and security systems are a precondition to new entry.

IATA is an international organisation whose members are most of the credible civil aviation operators. A list of the IATA members in the Asia Pacific region

is attached as Appendix 1. It deals with the terms and conditions of carriage for passengers and freight. It also acts as a 'clearing house' for interline bookings where passengers travel several sectors on more than one carrier.

From time to time there have been criticisms that IATA is a restraint on trade. However, it provides simplified rules for international and, in some cases, domestic travel and also provides assurances about 'ticket security' to passengers holding IATA tickets or E tickets from an IATA accredited airlines. It also provides certainty to participating airlines for payments. It reduces the prospects of passengers losing out of disreputable travel agents and airlines.

Air Niugini Limited is the only IATA accredited airline in Papua New Guinea which provides international travel with inter-line options with other carriers. None of the other PNG registered airlines have accreditation which limits their ability to be involved in world wide distribution arrangements which are important for the development of tourist travel. It should be noted that although they are very much smaller airlines than Air Niugini that Solomon Airlines, Polynesian Airlines and Air Vanuatu are IATA accredited.

In addition to the international regulatory bodies Air Niugini's (as is the case for any other airline) is subject to the rules and protocols of the countries to which it flies. In the case of ANG the most important is Australia and the others are Singapore, Japan, the Philippines and Solomon Islands. ANG now runs a weekly service to China (Hong Kong) and flew to New Zealand for maintenance of the B767-300.

Australia operates a very high level safety and security regime which is mandated under its Civil Aviation legislation and administered the Civil Aviation Safety Authority (CASA).

The provision of air traffic and other services at Australian airports is provided by another Australian government agency – Air Services Australia. All the major capital cities airports are privately owned. Many of the regional airports are owned by the local council or private companies and several which serve also as military airports by the Australian government.

The determination of capacity on routes to and from Australia are assessed by the Australian International Air Services Commission(IASC). While the initial hearing of the IASC reached a view that the Code share between Qantas and Air Niugini meant that “Neither party is likely to price aggressively” Air Niugini submits that the IASC conclusion has not been the case. There has been and remain competition between the two airlines over the sale of the Hard block seats. It is also in competition to sell the soft block seats. In addition there has been strong competition by Air Niugini with Qantas to secure freight traffic between PNG and Japan and PNG and the Philippines.

In the case of both airlines there is always the challenge of another airline such as Virgin Blue, Airlines of PNG or Jetstar entering the route.

As has been pointed out in the ICCC draft report Qantas, for a variety of reasons, did not endeavour to operate its own aircraft and crews into PNG. Had the code share not been entered into Air Niugini may have been the dominant carrier with monopoly instead of currently competing two carriers. Thus, the current form of block code share arrangement maintains the competition.

Airlines of PNG have proposed to the ICCC that “seating capacity on international services should be opened to tender”. There is nothing to prevent any travel agent or airline offering to buy some or all of the seats that are available on either the international or domestic flights of Air Niugini. This is done already with other international and domestic airlines by large travel agencies such as ‘Flight Centre’ and ‘Harvey Norman Travel ‘ in Australia.

One of the major problems with the proposal for open tender is that Airlines of PNG is not accredited with IATA and in terms of guaranteeing payments for onward travel on other airlines, administering terms and conditions for passengers that are different to those of ANG and Qantas the costs of administration would be high. In addition although the seats might be issued under the name of Airlines of PNG ANG and Qantas would end up taking the responsibility for Airlines of PNG passengers. Further, such a system will add more regulation than the market forces and competition driving the prices giving advantage to customers.

If Airlines of PNG is confident that its allegations about ANG's pricing are correct and it believes the market is large enough it should either lease or buy an aircraft for international services or enter into a code share arrangement with a competitor to Qantas. ANG notes that Airlines of PNG is leasing one of the over 30 year old Boeing B737 aircraft that were operated for a very short time by the failed OZJET airline in Australia. This aircraft has been manufactured prior to the Independence of Papua New Guinea. It notes also that it is single class and that while the fares are lower than those of ANG on introductory fares, the conditions attaching to making and fulfilling the bookings are much more restrictive i.e. has to be done on the Internet and if travel is not undertaken there is a total loss of the fare. Rest of the fares offered are in many cases more costly to the traveller than the ANG travel options.

As with the competition from Airlines of PNG on the Port Moresby to Cairns and return route ANG submits that the introduction of the services indicates that the PNG Government's 'Open Skies' policy works. In commercial terms the support for and the longevity of these services will verify in the aviation market place if the total market can be grown.

Meantime ANG will commercially match the competition and believes that the market should be allowed to operate.

In this respect ANG submits that the decision of Airlines of PNG onto the Cairns and Brisbane routes verifies that in terms of competition policy the criteria in (iv) and (v) above are met i.e. ease of entry of new competitors and active competition between competitors.

Because of the problems in PNG with the efficient and transparent administration of market regulations ANG submits that the Airlines of PNG proposal for tendering seats on international flights is far better handled in terms of competition policy by different airlines offering separate services that can be distinguished by the standard of the aircraft, the types of service offered and the fares.

In relation to the ANG – Qantas code share arrangement the history is well known and does not need to be restated. At the time the code share was signed

the imperative was the continuing existence of an airline that could meet both PNG's domestic and international requirements. In brief there was no alternative.

Air Niugini while understanding the arguments put by the Australian IASC supports the views stated by the Australian Productivity Commission and set out at page 66 of the ICCC draft report.

4.The operational and financial issues associated with the PNG aviation industry that influence or impact upon the industry and ANG in particular.

The ICCC report has dealt comprehensively with the :

- Significant and in some cases 'drop dead' problems associated with the CAA PNG and the administration and financing of the aviation sector assets and the regulatory regime.

For the greater part ANG agrees with the ICCC's observations about the CAA PNG and the operation of the regulatory regime and the funding and management of the CAA's assets. As indicated earlier in this response ANG submits that urgent effective action is needed to deal with the regulatory regime and the asset management .If urgent action is not taken competition policy will be irrelevant because there will not be a sustainable aviation sector in PNG

- Most of the constraints on ANG (or any other airline) matching international competition are additional costs added because of historical policies such as adherence to a cumbersome award based system for the remuneration of airlines staff, a lack of an efficient telecommunications system, inflexibility in the issue of work permits for critical technical and operational staff that cannot be met in the short run from local resources, localised safety and security problems that cause restrictions on flying times and sluggishness in finalisation of legal and other disputes before the PNG courts e.g. unfair dismissal claims.

- An expectation that ANG as the incumbent airline will ‘free carry’ its competitors in the provision of terminal and other services, and
- Difficulties in extracting payments for passenger and freight carriage from some government departments.

The issue of training and development of pilots, cabin crews, engineering staff and supervisors and accountants and auditors is a major one. There are shortages of staff in a number of these categories and staff that have been trained by ANG are regularly recruited by other organisations both in PNG and overseas. For example there are at least four ANG trained pilots flying with Emirates and a number of the qualified engineering staff working overseas.

Building and maintaining highly qualified staff is a key objective for any successful airline.

The Airline accepts that there is no quick fix for any of these problems but as the largest PNG registered airline which is also government owned there is an expectation in some quarters that these functions should be carried out and the costs absorbed by the Airline. Any costs associated with core infrastructure issues such as this will inevitably find their way into airfares. The Airline is not a ‘Magic Pudding’ that can continually provide services for which there is no payment.

The Airline submits that if the State wishes to see the profitable continuation of a State owned airline and the growth of the a successful aviation sector it must implement policies that encourage international competitiveness and remove restraints that prevent or restrict the Airline from responding to cost pressures out of its control e.g. the recent increase in oil prices.

5. Factual Matters that arise within the ICCC report.

In general the ICCC has provided a wide ranging assessment of the PNG aviation sector. However, there are elements of the report that need to be commented upon in order to ensure that the ICCC has an adequate understanding of the problems confronting the sector and ANG in particular.

At page 10 the ICCC Draft Report suggests that “. . .it is important for both parties to agree on reasonableness of charges made for air services provided by the CAA.”. It is important to note that there have been numerous discussions, exchanges of correspondence between ANG and the CAA PNG about the nature, the levels and the reasonableness of charges. Without accurate and up to date data it would be impossible to make comparisons with international benchmarks. Having said this ANG submits that CAA is attempting their best efforts to meet their service obligations to serve its customers despite the resource constrains.

At page 11 the ICCC Draft report states there is merit “in considering a separation of the various roles and responsibilities of the CAA.” As indicated earlier in this submission ANG understand that the Government has given such a proposal consideration.

At page 13 the ICCC notes that in relation to the training of travel agents that there is ‘the potential for anticompetitive outcomes from this practice.’ As pointed out earlier in this report ANG is the National Distribution Centre (NDC) for Gallelio Global Distribution System in PNG. Consequently, as part of its responsibilities, all travel agents are trained by a separate section in ANG that deals with Gallelio. Contrary to the submissions by other airlines, ANG reconfirms to the ICCC that the system used by ANG to carry out its business is Computerized Reservation System (CRS) and not a GDS. Gallelio is a GDS which is governed by very strict and stringent competition rules applied in USA. Gallelio and all other similar GDSs provide equal access to all airlines and such access levels are controlled in USA by the system owners and not ANG. This myth must now be cleared. Airlines of PNG is operating in SITA systems and has not link to ANG. Airlink is sub-hosted with a separate partition in SITA and is managed by Airlink staff on their own. Very clearly, ANG do not control any Airlink system activities and except ANG charges them for sub-hosting and communication charges. Airlink schedule upload, airfare upload and all inventory management are done by their staff. ANG will be pleased to provide further information in this regard.

There is nothing to prevent any other PNG registered airline from obtaining another GDS implementation.

In relation to the domestic fares comparisons at pages 23 to 25 ANG has submitted earlier in this submission why the comparisons may not be valid

It should also be noted that over the last three years ANG has introduced an increasingly sophisticated yield management system but the extent to which it can do so is constrained by the reliability (or lack of it) of the telecommunications system.

At page 26 the ICCC suggests that there is no competition on the Port Moresby to Cairns route. Not only does Airlines of PNG operate a service to Cairns and return but also some of the charter services from the Highlands direct to Cairns and return constitute effective competition because they carry passengers who would otherwise transit in Port Moresby.

At page 28 the ICCC claims that ‘Air Niugini is able to charge at whatever rate it wishes with its main focus being on passengers which are able to pay these fares, that is mainly business travellers or travellers who are travelling to PNG as part of their employment’. As indicated earlier in this report this is not the approach to setting of air fares – both actual and threatened competition are taken into account . In addition to Board has deliberately taken the view that it is in the Airline’s and the national interest to set fares that encourage return travel by ‘discretionary spenders’ in the tourist market.

At page 29 the ICCC draft report implies that 58.1% average load factor over the past four years in high (see the immediately preceding sentence). ANG disagrees 58% would not be regarded as a satisfactory average load factor by any profitable international or domestic airline 70% plus would be the appropriate figure.

At page 66 the last paragraph states that the Qantas-ANG code share was never “independently assessed as to whether there were alternative options that could have been adopted” There was no formal consideration by the ICCC. However, there was a consideration by the Australian IASC and the ICCC draft report has referred to that determination by the IASC. ANG would regard the IASC as being independent. It recommended to the then Australian Minister for Transport that the code share should proceed.

In addition ANG has referred earlier in this submission to the Australian Productivity Commissions report on code share arrangements and submits that the APC 's conclusions apply to this particular code share.

SECTION OMITTED DUE TO CONFIDENTIALITY ISSUES

The Airline also had to take into account that it faced substantial upgrade costs on an ageing Airbus aircraft which if it did not enter into a code share arrangement the revenues would not be available to maintain a profitable, independent service on the Airline's international routes.

Enquires were made about possible other code share partners in the region and there was no interest.

Thus it is ANG's views that the conclusions on page 66 cannot be sustained.

In relation to the distribution network ANG currently operates in conjunction with several international software systems that enable outgoing and incoming passengers (and freight) to be offered a comprehensive, total booking service.

With the exception of former Communist countries no country operates a 'one stop shop' distribution system. Even Cuba does not do so.

Although it might be a 'not for profit' organisation it would be a monopoly provider and in a country such as PNG would require a great deal of goodwill and financial support to make it work.

Overseas travel operators would have strong reservations about having to deal direct through a monopoly provider and the medium to long term outcome would be contrary to the objective of growing the PNG tourism market.

At page 70 the ICCC offers some options for maintaining marginal routes in PNG. As indicated earlier in this report the phasing out or unavailability of AVGAS and the state of some of the smaller regional airports may determine an outcome that does not fall into any of the six options suggested.

While some aspects of the marginal routes issue are more urgent for smaller airlines it is still an important issue for ANG. There are several domestic services that are marginal but ANG continues to operate because of the 'national interest'.

Initially, ANG believes that the least worst and most transparent option is No.4. ANG would like to take further time to consider the options proposed by the ICCC in its draft report and make further submissions.

It is essential to point out that a fundamental element or condition precedent in making a decision about what is the best option is the reaction of the State and the CAA PNG to the ICCC's draft observations and recommendations about the CAA PNG and the action taken to deal with the airports and regulatory regime.

6.Recommendations:

ANG recommends that:-

- Urgent action and funds allocation to deal with the CAA PNG and the state of PNG's airports and safety and security infrastructure,
- The asset owner and the regulator should be effectively separated and not just by internalize separation,
- The PNG government's 'open skies' policy should remain in place,
- The PNG government to negotiate a level playing field between PNG and Australia in the access of air services and in particular secure agreement from the Australian Government for the removal of the practice of cabotage,
- Air fares should continue to be set on the basis of market forces and not arbitrarily determined by regulatory body,
- That where possible there should be no cross subsidies between international and domestic services,
- A concerted effort should be made by the PNG tourist sector to develop a set of working relationships with the airlines similar to that with Fiji and New

Caledonia and that funding be made available from the sector for sustained promotion of PNG as a tourist destination, and

- The ICCC in conjunction with the aviation industry examine and make recommendations to government to achieve workable solutions to the problems of small regional airports and the decreasing availability and increasing prices of AVGAS in remote locations.