



21 August 2006

Mr Thomas Abe
Commissioner and CEO
The Independent Consumer and Competition Commission
PO Box 6398
1st Floor, Garden City Complex
Angau Drive
BOROKO
National Capital District

Dear Sir

REVIEW INTO THE AIR TRANSPORT INDUSTRY IN PAPUA NEW GUINEA (PNG)

Qantas wishes to make this written response to the draft report on the Air Transport Industry of PNG, released by the Independent Consumer and Competition Commission (ICCC) on 18 July 2006.

In particular, we wish to comment on the observations in the draft report concerning the codeshare arrangements that exist between Qantas and Air Niugini for services between Australia and PNG.

Qantas notes that it is the intention of the ICCC to review these arrangements in mid 2007 to coincide with their anticipated review by the International Air Services Commission (IASC). Qantas expects to participate fully and co-operatively in both processes in compliance with the requirements of the ICCC and the IASC.

In advance of these reviews, however, and the ICCC's final report to the Treasurer, Qantas takes this opportunity to express its strong support for the existing codeshare arrangements and to outline the benefits to the travelling public that derive from a strong on-going relationship between Qantas and Air Niugini.

Qantas/Air Niugini Relationship

The codeshare relationship between Qantas and Air Niugini dates back to 1987 when Qantas first applied its code to services operated by Air Niugini between Port Moresby and Cairns.

As noted in the draft report, in September 2002, this arrangement was expanded for a five year period under a commercial agreement which allows Qantas to codeshare on all of Air Niugini's services to Australia. Under this arrangement, Qantas has agreed to purchase a hard block of seats on Air Niugini's services between Port Moresby and Cairns as well as between Port Moresby and Brisbane/Sydney. Qantas also has access to an additional soft block of seats on both routes should this be required.



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In addition, Qantas agreed to purchase cargo space from Air Niugini and to provide assistance in training and the establishment of maintenance systems for B767 operations.

Air Niugini is a member of the Qantas Frequent Flyer Program and Qantas provides both ground handling and catering services to Air Niugini in Australia on a commercial basis.

Authorisation by the IASC

Under Australian law, implementation of the codeshare agreement between Qantas and Air Niugini requires approval by the IASC against criteria laid down in a Policy Statement issued by the Minister for Transport and Regional Services. In examining codeshare proposals on routes such as those between Australia and PNG, the IASC also consults with the Australian Competition and Consumer Commission (ACCC) on competition issues associated with the proposal.

IASC authorisation of the codeshare agreement, which was finalised by the parties in September 2002, was provided to Qantas in a decision dated 8 August 2002.

Qantas is not aware of any involvement by the ICCC in the decision of the Government of PNG to authorise Air Niugini to conclude these codeshare arrangements with Qantas.

Benefits of the Codeshare

The draft report provides an abbreviated summary of the IASC's assessment of the codeshare at page 64. The full Decision of the IASC is obtainable on the IASC website.

In conclusion, it was the assessment of the IASC that:

"The clear and real risk of the loss of a principal operator from the PNG route, leaving sharply reduced levels of service and associated public benefit, leads the Commission to the conclusion that it should authorise the new arrangements."

In support of its application, Qantas had identified a number of key benefits:

Air Niugini's financial situation was at a critical stage. Its losses had increased considerably due to domestic influences and management related issues and the PNG Government, faced with a range of financial challenges, was no longer in a position to continue to underwrite the carrier's losses;

in the absence of a commercial understanding with Qantas, Air Niugini would be forced to withdraw from the route and this would have very serious consequences for the Airline and the economy of PNG;

- continuation of a reliable, regular, and frequent airline service between PNG and Australia was essential to the social fabric and economic prosperity of PNG;

PNG's tourism prospects would be impacted very severely in the absence of viable air services to/from Australia;

the improvement in Air Niugini's financial situation expected to result from the codeshare agreement would enable Air Niugini to lease a B767 aircraft from Air New Zealand to replace its aged A310 which was contributing to cost escalation and declining passenger service standards on the Australia route;

- the availability of such an aircraft was essential for Air Niugini's international operations on other routes and to provide network support for domestic operations;
- the hard block construction of the codeshare was such that Qantas had a commitment to purchase around 35% of the total capacity on the aircraft, regardless of whether these seats were sold on each flight establishing an incentive for competitive pricing between the two carriers;
- the codeshare would enable a greater level of service to be operated between the gateway points of Brisbane and Sydney than if Qantas was to operate the route on its own. This was seen to be of particular benefit to business travellers;
- the codeshare would result in a significant improvement in product standards with the transition to a B767 aircraft.

Finally, and most importantly, it was noted by Qantas that the proposal had the endorsement of political leaders on both sides who agreed on the importance of the proposed arrangement for the restructuring of Air Niugini. Qantas also noted that this had been given further emphasis in a media release dated 7 July 2002 by the then Prime Minister of PNG, Sir Mekere Morauta.

Current Situation

It is apparent from its public statements that Air Niugini has improved its financial position since 2002. The Airline ascribes this to a number of measures introduced since that time, including the impact on profitability of its Australia operations. It is also true, however, that the Airline's restructuring is not complete and that, notwithstanding some recent expansion in its international operations, Air Niugini's network and opportunities for viable international expansion are limited.

It is clear to Qantas that operations to Australia will continue to represent the majority of Air Niugini's international flying for some time to come and that further improvement in Air Niugini's financial situation will be conditional on its continued presence on routes to Australia.

It is also clear to Qantas that in the absence of a close and continuing commercial relationship between the two carriers, Air Niugini would struggle for viability and survival with its services to Australia.

In this regard, Qantas contends that the benefits to PNG, apparent when the codeshare agreement was initiated remain both contemporary and relevant.

Changes to the Competitive Landscape

It is important to note also that the competitive landscape is changing with the announcement that, in addition to its Cairns/Port Moresby operations, Airlines PNG will begin operations on the Brisbane/ Port Moresby route with effect from 21 August.

Qantas notes also that Queensland Regional Airlines has applied to the IASC for capacity to operate six times per week between Cairns and Port Moresby.

There is no impediment to the designation of additional carriers to operate on routes between PNG and Australia under the Air Services Agreement. The net effect of this is that airlines on both sides that meet the respective nationality requirements of Australia and PNG are free to access the route and to take up the unused capacity that exists under this Agreement.

This suggests there is no shortage of opportunities for new entrants to exert competitive pressure on the incumbents in the PNG/Australia market.

Pricing Impact of the Codeshare with Air Niugini

Qantas notes that the draft report makes a number of unfavourable references to the international comparability of Air Niugini's fares to Australia on a per passenger basis and that the codeshare with Qantas impacts on price competition between the carriers.

Qantas is not privy to the factors that influence Air Niugini's market prices other than the amounts paid by Qantas to Air Niugini for capacity hire under the codeshare contract.

As a general proposition, however, Qantas does not believe that it is possible to attribute price differentials to one particular factor or to compare fares on different routes without reference to all of the factors at play in each market. These include different cost structures, the underlying sustainability of the routes in question, the social impact and national interest responsibilities of the various players and the individual characteristics of the markets themselves.

Qantas also notes again that the block space nature of the codeshare agreement with Air Niugini has a positive effect in maintaining price competition between the participants.

Alternative capacity sharing arrangements such as those proposed by Airlines PNG and outlined at page 65 of the draft report, or price controls, fail to take into account the risks and complexity involved in operating international air services. These proposals would not, in Qantas' view, be conducive to the establishment of long term viable airline operations and would prejudice the survival prospects of Air Niugini.

Yours sincerely



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