

Air Niugini Limited

Submission to the ICCC in Support of Authorisation of the Proposed Renewal of the Codeshare Agreement with Qantas Airways Limited

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EXECUTIVE SUMMARY

Introduction

This submission is made by Air Niugini Limited (**Air Niugini**) in support of an application for authorisation of a renewed codeshare agreement (**Renewed Codeshare Agreement**) with Qantas Airways Limited (**Qantas**). This agreement will be in similar terms to the current codeshare agreement (**Current Codeshare Agreement**), which expires on 31 August 2007.

Air Niugini's codeshare agreement with Qantas has now been in place for over four years and has delivered higher quality, higher frequency jet services between Papua New Guinea and Australia than ever available before. At the same time, it has led to lower fares, with average fares on all codeshare routes reducing significantly in real terms since 2002.

Importantly for Papua New Guinea, the codeshare makes it possible for Air Niugini to operate widebody aircraft services. Without these aircraft, Papua New Guinea would lose its only current source of commercial air freight services.

Without the codeshare, Air Niugini would be forced to become a much smaller, less significant airline. Many jobs would be lost, the economy would lose substantial foreign earnings, and businesses such as retail, mining or fishing that rely on imports or exports would be forced to pay substantially more for their air freight, with flow on consequences of higher prices and lower prosperity throughout the economy.

The benefits that Air Niugini's codeshare arrangements with Qantas deliver to the nation are therefore large. These benefits and the reasons for them are explained in this submission.

The importance of widebody aircraft

Air Niugini has traditionally operated 'widebody' aircraft on its international services. In broad terms, a widebody aircraft is one with two aisles in the passenger cabin rather than one. Widebody aircraft have a wider fuselage diameter and are always larger aircraft than a single aisle 'narrowbody' aircraft.

Widebody aircraft offer important advantages over narrowbody aircraft. These include:

- The ability to carry containerised freight. This is critical if an airline is to offer efficient air freight services. Without a widebody aircraft, Air Niugini could no longer provide air freight services;
- Greater range than a narrowbody aircraft. This allows Air Niugini to provide direct services to distant destinations such as Japan and Singapore¹;
- Greater passenger comfort; and

¹ Some narrowbody aircraft have recently been developed that offer sufficient range to safely operate such sectors. These aircraft, however, are still uncommon and, because they are new, expensive to acquire.

- If sufficient passenger loads can be achieved, more efficient operations with lower costs and lower greenhouse emissions per passenger than a narrowbody aircraft.

The advantages of widebody aircraft and, in particular, their ability to carry commercial air freight, come from their greater size. That size also means, however, that more passengers are required in order for services to be economically viable.

The market for air passenger services between Papua New Guinea and Australia (the **Australia Air Passenger Market**) is too small for two carriers to sustain widebody aircraft services of the quality and frequency that consumers in Papua New Guinea have come to expect. Air Niugini therefore could not sustain widebody passenger operations between Papua New Guinea and Australia on its own.

Indeed, by attempting to do so, Air Niugini has already come close to financial ruin once before. In 2001, prior to the Current Codeshare Agreement, Air Niugini reached a position of serious financial difficulty by attempting to sustain a widebody operation in its own right between PNG and Australia. The resulting losses led to a position where the airline owed many millions of Kina to major suppliers and was almost placed into administration by creditors. Having reached this major financial crisis, the then Board of Air Niugini recognised that the Australia/PNG routes could not continue to sustain two widebodied operators and, as part of its “flightpath to recovery” strategic plan, decided to enter into the Current Codeshare Agreement.

[CONFIDENTIAL INFORMATION DELETED]

Since Air Niugini would be unable to maintain widebody passenger services between Papua New Guinea and Australia on its own, and since a widebody aircraft is necessary in order to carry commercial freight, it follows that Air Niugini could not maintain an air freight business on its own.

The codeshare arrangements between Air Niugini and Qantas address this problem by enabling Air Niugini to sell a proportion of the capacity on its widebody B767 aircraft to Qantas for resale. Qantas’ extensive Australian sales network and customer base mean it is able to sell seats on these services that Air Niugini could not sell on its own. In effect, Qantas and Air Niugini share the capacity of the aircraft to achieve a higher frequency, higher quality service for consumers than either could offer on its own.

In this way, both Air Niugini and Qantas can continue to offer high frequency services with all the advantages of efficiency, passenger comfort and the ability to carry freight that come from a widebody airliner.

Pro-competitive structure of the codeshare

A codeshare is an arrangement where one airline (the **marketing carrier**) buys seats on a flight operated by another airline (the **operating carrier**) to sell to the marketing carrier’s customers. Codesharing is an important form of airline competition. In the modern aviation industry, codesharing has become common, with recognised potential for delivering a lower seat cost to the

operator and lower airfare to the travelling public. Many governments entering into Air Service Agreements around the world recognise and endorse codesharing.

Qantas operates in a more mature and developed market than Air Niugini and yet still relies significantly on codeshare capacity. Air Niugini understands that Qantas currently participates in over 20 codesharing agreements on various routes on its network, and there are currently hundreds of codesharing agreements between the world's airlines. A survey of the myriad of codesharing and alliance arrangements implemented around the world is set out in Airline Business' *Airline Alliance Survey 2006*, a copy of which is attached at Annexure H.

Codeshare arrangements typically fall into two broad types:

- (a) 'hard block'; or
- (b) 'free sale'.

Under a free sale codeshare, the marketing carrier only pays the operating carrier for seats if it actually sells them.

By contrast, under the codeshare arrangements between Air Niugini and Qantas, seats are allocated to Qantas on a 'hard block' basis. This means they must be paid for whether Qantas sells them or not. The hard block allocation that Qantas is required to purchase is significantly higher than the number it normally sells. Unsold hard block seats represent an absolute loss to Qantas. Qantas therefore has a strong incentive to market these seats aggressively in competition with Air Niugini.

Under the codeshare arrangements, each carrier, independently from the other:

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

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

In addition, both carriers face effective competition from Airlines of PNG, and from the knowledge that, if prices were to rise above competitive levels, barriers for other carriers to enter the market are low. Papua New Guinea's "open skies" policy ensures that this will remain the case.

Results of loss of the codeshare for Air Niugini and Qantas

Without the codeshare, Air Niugini believes Qantas would recommence its own services.

Consumers in Papua New Guinea have become used under the Current Codeshare Agreement to high frequency jet services to Australia. Therefore, to be perceived as competitive, Qantas would have to introduce a jet service with at least 5 to 7 frequencies per week.

However, in introducing its own service, Qantas would face the same problem as Air Niugini – demand between Australia and Papua New Guinea would not be sufficient for Qantas to support widebody air services with this level of frequency. Accordingly, any Qantas service would have to be operated with smaller, narrowbody aircraft. Even this, however, would increase the current levels of capacity between Papua New Guinea and the major cities of Sydney and Brisbane by almost 50%.

With the loss of codeshare support and the increased capacity on Australian routes from new Qantas services, it is inevitable that continued high frequency widebody services by Air Niugini would become unsustainable. Air Niugini's projections show that, if it were to attempt to sustain its current level of service without the codeshare, this would result in losses of over [CONFIDENTIAL INFORMATION DELETED] per year, and a total loss of profitability (ie taking into account the profits that would otherwise have been made) of over [CONFIDENTIAL INFORMATION DELETED] per year.

In the short term, therefore, Air Niugini would seek to stem its losses by reducing the frequency of its Australian widebody services from 6 per week to only [CONFIDENTIAL INFORMATION DELETED] per week. Without the codeshare, even this level of service would still result in losses in the order of [CONFIDENTIAL INFORMATION DELETED] per year. [CONFIDENTIAL INFORMATION DELETED]

In the longer term, therefore, Air Niugini would have no alternative but to withdraw from widebody services and replace its B767 with a narrowbody aircraft with sufficient range to service Air Niugini's international destinations, such as an Airbus A319ER, or a long range version of Boeing's 737.

Loss of Airlines of PNG

Air Niugini's aircraft lease obligations mean that it would take Air Niugini some time to restructure its services and reduce the size of its operations in the way described above. In the interim, it is inevitable that all airlines operating services between Papua New Guinea and Australia would sustain heavy losses.

As a national carrier, the losses made by Air Niugini would be a direct loss to the people of Papua New Guinea that the nation can ill afford. Government backing, however, means that Air Niugini would ultimately survive until such time as it could stem its losses by reducing the scale of its business and withdrawing from widebody operations. The substantial financial resources of Qantas mean that it also would survive a period of loss making on Australian routes.

Airlines of PNG, however, has neither the financial resources of Qantas, nor the ultimate government backing of Air Niugini. It is therefore likely that they would not survive the market restructure that would result from the loss of the current codeshare arrangements. The result is that, even if loss of the codeshare resulted in the introduction of one new operating carrier (ie, Qantas), it would be likely to result at the same time in the loss of another (Airlines of PNG) and the scaling back of Air Niugini's services.

Loss of the codeshare would therefore ultimately result in no increase in the number of operating carriers, and a reduction in the number of marketing carriers.

Summary of benefits of the codeshare

The codeshare between Air Niugini and Qantas therefore provides a wide range of benefits for both Air Niugini and the nation of Papua New Guinea. These are summarised below.

- Competition in the Australia Air Passenger Market.

The market for air passenger services between Papua New Guinea and Australia (the **Australia Air Passenger Market**) is currently served by two operating carriers - one larger operator and one smaller. After the restructure that would follow the loss of the current codeshare arrangements, this would remain the same, but the large operating carrier would be Qantas instead of Air Niugini, the smaller operator would be Air Niugini instead of Airlines of PNG, and neither carrier would operate widebodied aircraft. The ultimate likely effects can be summarised as set out in the table below.

| | Operating carriers | Marketing carriers | Efficiencies |
|-----------------------------|---|------------------------------------|---|
| With codeshare | 2 – One large (PX/QF) and one smaller (Airlines of PNG) | 3 – QF, PX and Airlines of PNG | Achieve efficiencies of combining traffic on B767 |
| Without codeshare | 2 – One large (QF) and one smaller (PX) | 2 – QF and PX | All or most capacity narrowbody |
| Effect of loss of codeshare | Nil | loss of 1 marketing carrier | loss of efficiencies of B767 |

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

Further details of the effects of the codeshare on competition in the Australia Air Passenger Market are set out in sections 7, 10 and 11 of this submission.

- Cost and availability of air freight services

The economy of Papua New Guinea is highly dependent on air freight services. Most of the nation’s fresh dairy products, fruits and vegetables are imported by air freight, Similarly, the nation’s seafood and other exports rely on the availability of efficient air freight services.

As described above, by making high frequency widebody passenger services possible, the codeshare also enables the provision of high frequency, high efficiency air freight services to and from Papua New Guinea, and allows both Qantas and Air Niugini to sell these services in competition with one another.

As discussed above, loss of the codeshare would force Air Niugini to cease widebody services. Since the nation’s air freight is carried exclusively by these services, this would

leave the nation without air freight services. Ultimately, Papua New Guinea would be forced to rely on more expensive and less efficient freighter operations. The higher operating costs of such services means that air freight prices would be likely to increase by at least 30%. Alternatively, Qantas may take the opportunity to become the sole or nearly sole supplier of air freight services. Either outcome represents a less efficient, less competitive outcome than will result from authorisation of the Renewed Codeshare Agreement.

In addition, without Air Niugini's international widebody services, Papua New Guinea would suffer the loss of direct air freight services to any of Japan, Singapore, Hong Kong, Fiji or the Philippines. Exporters to these countries would therefore not only have to pay more to ship their products to Australia, but would then have to pay an additional amount to ship their products on from Australia to their ultimate destination. The effect on important export industries such as Papua New Guinea's fishing industry would be potentially devastating.

For further details of the competition effects of the codeshare on Air Freight Markets, see sections 8, 12 and 13 of this submission. Details of the public benefits resulting from the greater air freight capacity made possible by the codeshare are set out at section 17.

- National economy

Authorisation of the codeshare arrangements will result directly in an **improvement in Papua New Guinea's international balance of payments of over K610 million over the life of the Renewed Codeshare Agreement** when compared to loss of the codeshare.

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

Further, with loss of the codeshare, Air Niugini will become a smaller airline with less flying across to spread fixed costs. The result may be to increase the business's break even prices domestically as well as internationally. This may lead to increases in domestic airfares and a reduced ability for the airline to continue to operate loss making or marginal domestic routes which are currently carried out as a community service obligation.

Further details of these benefits are set out at sections 15 and 16.

- Employment

Loss of authorisation would result in the direct loss of at least 50 to 100 jobs immediately. Ultimately, as Air Niugini would be forced with loss of the codeshare to become a smaller, less significant airline, larger scale restructuring and job losses would be required. Air Niugini estimates that, ultimately, it would be forced to bring its workforce close to 900 employees from its current level of 1350. The flow on effects through the economy of higher air freight costs are also likely to cost many more jobs. This is discussed at section 21 of the submission.

- Improvements to services

The codeshare arrangements with Qantas allow a higher standard of services to be provided to Papua New Guinean consumers in a range of ways. [CONFIDENTIAL INFORMATION DELETED]

The codeshare also makes high frequency jet services to Cairns possible. Without the codeshare this route would be serviced by smaller, slower “Dash 8” aircraft. Finally, by making widebody services to Brisbane possible, the codeshare provides passengers with a smoother ride and, for many passengers, a greater sense of security and wellbeing than narrowbody aircraft.

These benefits are discussed further at section 18 of the submission.

- Efficiency

The widebody services made possible by combined codeshare operations provide substantial efficiencies compared with the likely alternative of two separate narrowbody services. These efficiencies are discussed at section 19 of the submission.

- National flag air carrier

The codeshare provides benefits to the nation by underpinning the strength of Air Niugini as the nation’s national carrier in a range of ways. This benefit is described at section 22 of the submission.

Conclusions

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

Air Niugini therefore requests that the Independent Competition and Consumer Commission authorise these codeshare arrangements pursuant to section 70(1) of the *Independent Consumer and Competition Commission Act 2002*.

PART A - INTRODUCTION

1. APPLICATION FOR AUTHORISATION

This submission is made by Air Niugini Limited (**Air Niugini**) in support of an application for authorisation pursuant to section 70(1) of the *Independent Consumer and Competition Commission Act 2002 (ICCC Act)* to enter into and give effect to a renewed codeshare agreement (**Renewed Codeshare Agreement**) with Qantas Airways Limited (**Qantas**).

The Renewed Codeshare Agreement will be in similar terms to the existing codeshare agreement, dated 1 September 2002 (**Current Codeshare Agreement**). Together, the Renewed Codeshare Agreement and the Current Codeshare Agreement are referred to in this submission as the **codeshare arrangements**.

This submission and its annexures include certain commercially confidential information. Disclosure of that information could result in material financial loss and prejudice the competitive position of Air Niugini. Air Niugini requests that this information be kept confidential by the Commission and excluded from the register kept by the Commission in accordance with section 131 of the *ICCC Act*. For convenience, the confidential information is indicated by the use of bold red square parentheses (**[]**) around confidential text or around the heading of a confidential table, figure or Annexure in the confidential versions of the submission. This information has been deleted and replaced with '**[CONFIDENTIAL INFORMATION DELETED]**' in the non-confidential version of the submission provided to the Commission.

Air Niugini requests that the ICCC raise any issues or questions it may have in relation to the Codeshare Renewal or this submission with Air Niugini through its lawyers, Blake Dawson Waldron.

2. DESCRIPTION OF THE PARTIES

2.1 Air Niugini

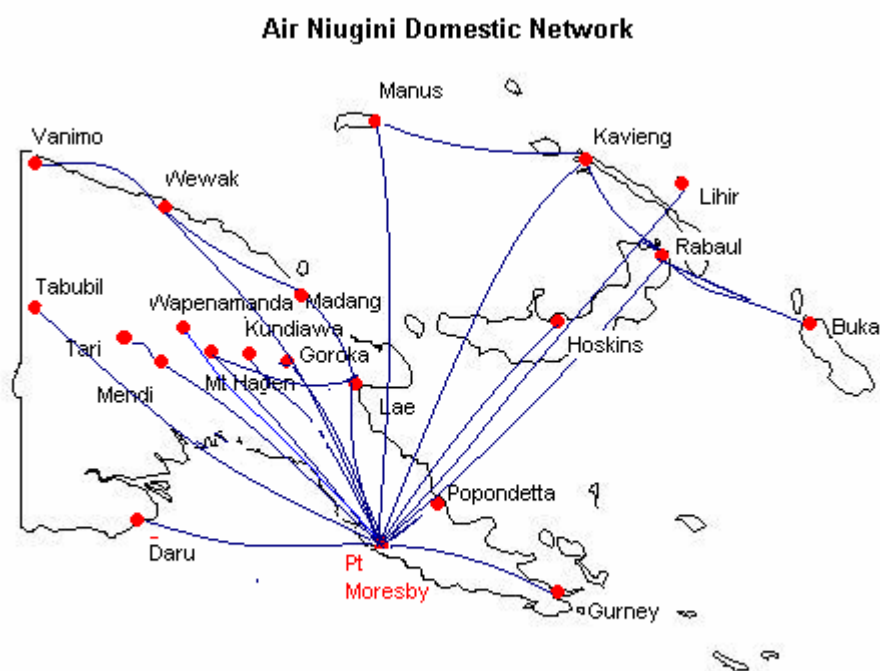
Air Niugini was incorporated, and began operating, in 1973 as the national airline of Papua New Guinea. The company was originally owned by the Papua New Guinean government (60%), Ansett (16%), Qantas (12%) and Trans Australia Airlines (**TAA**) (12%). In 1976, the Papua New Guinean government bought out the Qantas and TAA holdings, and in 1980 acquired the Ansett shares to make the airline wholly government owned. Air Niugini is still 100% owned by the Papua New Guinean government.

Air Niugini is one of Papua New Guinea's largest and most respected companies. Air Niugini employs approximately 1350 people worldwide and is Papua New Guinea's largest airline. Air Niugini's turnover in financial year 2005/2006 was K531million

Air Niugini's main business is the transportation of passengers and air freight domestically and internationally. In addition to the core business of transporting passengers and air freight, Air Niugini maintains 21 retail sales offices throughout Papua New Guinea, provides in-flight catering for its own operations, operates a tours division packaging holidays for its customers and travel agent's customers around Papua New Guinea, and maintains offices in Brisbane, Cairns, Sydney, Singapore, Manila and Tokyo. These overseas offices not only sell tickets to the travelling public, but they also service the needs of Papua New Guineans who travel overseas and (in many ways) act as de facto Papua New Guinea tourism offices. Additionally, Air Niugini has appointed General Sales Agents who represent its and Papua New Guinea's interests in the UK, Scandinavia, Germany, Italy, Malaysia, Indonesia, Hong Kong, China, Taiwan, the USA, Fiji, Solomon Islands, New Zealand and South Korea.

Air Niugini operates domestic services between Port Moresby and 21 ports throughout Papua New Guinea, as shown in Figure 1, below.

Figure 1



In addition, Air Niugini operates international services between Port Moresby and 9 ports around the world, as follows:

- Sydney, Brisbane and Cairns International Airports, Australia;
- Narita International Airport, Tokyo, Japan;
- Changi International Airport, Singapore;
- Hong Kong International Airport, Hong Kong;

- Honiara Henderson International Airport, Solomon Islands;
- Nadi International Airport, Fiji; and
- Ninoy Aquino International Airport, Manila, Philippines.

Air Niugini's domestic and international fleet consists of the B767, 5 Fokker F-100 jets and 5 Dash 8 turboprop aircraft.

2.2 Qantas

Qantas is the world's second oldest airline and the eleventh largest airline globally in terms of Revenue Passenger Kilometers. In the year ended 30 June 2006, Qantas carried approximately 34 million passengers, providing services to 85 international destinations in 39 countries (including codeshare flights operated by other airlines) and regular services to 57 destinations throughout Australia.

Qantas operates a domestic and international fleet of 219 aircraft, comprising Boeing 747s, 767s, 737s and 717s, Airbus 330s and 320s, Bombardier Dash 8s, Bombardier Q400s and British Aerospace 146s.

The Qantas Group's airline businesses include Qantas (full service domestic and international services), JetConnect (domestic New Zealand and trans-Tasman services), QantasLink (regional Australian services) and Jetstar (low cost domestic and international services). In addition to its airline operations, the Qantas Group operates a portfolio of airline related businesses including airport operations, freight, engineering, catering and travel and accommodation booking. Qantas employs approximately 37,000 people worldwide.

Within Papua New Guinea, Qantas employs 21 local staff. 2 are based at Jackson's Airport in Port Moresby and are responsible for customer service and freight operations. 19 staff are based in the town office which consists of a retail travel centre, telephone sales call centre, administration and finance. All Qantas services between PNG and Australia are operated as codeshare services pursuant to the Current Codeshare Agreement with Air Niugini.

3. RATIONALE FOR RENEWED CODESHARE AGREEMENT

3.1 Widebody aircraft – freight carrying ability and other advantages

Air Niugini services Papua New Guinea with a wide range of both domestic and international air services. It has traditionally used 'widebody' aircraft in the provision of its international services.

In broad terms, a 'widebody' aircraft is one with two aisles in the passenger cabin, while a 'narrowbody' aircraft has only one. Examples of narrowbody aircraft are the Airbus 320 and the Boeing 737 and 757. In the economy cabin of these aircraft there are typically five or six seats in each row (two plus three or three plus three), divided by a single aisle.

Widebody aircraft have two aisles and up to 11 seats across the economy cabin. Widebody aircraft have a wider fuselage which allows a freight compartment large enough to carry freight containers. This is critical if freight is to be loaded and unloaded from an aircraft quickly and efficiently. By contrast, freight carried in a narrowbody aircraft must be carried 'loose'. This makes loading and unloading freight from a narrowbody aircraft too time consuming and inefficient to be commercially viable.

By definition, a widebody aircraft is always a big aircraft. Well known examples are Airbus 310 and 330, and Boeing 767, 777 and 747('Jumbo'). In addition to the ability to carry commercial air freight, widebody aircraft offer important advantages over narrowbody aircraft. These include:

- greater range than a narrowbody aircraft. This allows Air Niugini to provide direct services to distant destinations such as Japan²;
- greater passenger comfort; and
- if sufficient passenger loads can be achieved, more efficient operations with lower costs and greenhouse emissions per passenger than a narrowbody aircraft.

All of Air Niugini's long haul international services are operated using a leased widebody Boeing 767-319 aircraft (the **B767**). If Air Niugini were unable to afford to continue to operate this aircraft, it could not provide the air freight services upon which many sectors of the Papua New Guinea economy rely. The ability of Air Niugini to sustain widebody aircraft operations is therefore crucial to both Air Niugini and to Papua New Guinea as a nation.

3.2 Australia Passenger Market – Difficulty of maintaining widebody operations

Although the size of a widebody aircraft provides the advantages of range and the ability to carry freight, that same size also means that a widebody aircraft must carry many more passengers than a narrowbody aircraft to be economically viable. In Papua New Guinea, achieving this is difficult.

In order to sustain widebody aircraft operations, Air Niugini must achieve maximum utilisation of its aircraft across the whole of its international network. The services which account for the greatest proportion of Air Niugini's widebody aircraft operations are those between Papua New Guinea and Australia. The viability of continued widebody aircraft operations by Air Niugini therefore depends on achieving viable passenger loads on its Australian services.

Papua New Guinea has traditionally enjoyed a close relationship with Australia. In past decades there have been strong levels of investment in Papua New Guinea by Australian businesses, particularly in the mining sector. As a result, there has been a large population of expatriate Australians living in Papua New Guinea and travelling to and from Australia.

² Some narrowbody aircraft have recently been developed that offer sufficient range to safely operate such sectors. These aircraft, however, are still uncommon and, because they are new, expensive to acquire.

In more recent years, however, both the level of Australian business activity in Papua New Guinea and the number of Australian expatriates living in Papua New Guinea has reduced substantially. For example, at the beginning of the 1990's, Air Niugini believes that there were in the order of 20,000 to 25,000 expatriate Australians living in Papua New Guinea. There are now in the order of only 7,000 to 10,000.³

In international terms, the routes between Papua New Guinea and Australia are 'thin'. This means that Air Niugini has not been able to, and believes it is unlikely in the future to be able to, achieve sufficient loads on its own on its Australian routes to make widebody operations financially viable.

Indeed, in 2001 Air Niugini came close to financial ruin by attempting to sustain a widebody operation in its own right between PNG and Australia. The resulting losses led to a position where the airline owed many millions of Kina to major suppliers and was almost placed into administrator by creditors.

3.3 Need for the codeshare arrangements

The Current Codeshare Agreement addresses this problem by enabling Air Niugini to sell a proportion of the capacity on its B767 to Qantas for resale. Qantas' extensive Australian sales network and customer base mean that it is able to sell seats on Air Niugini's Australian services that Air Niugini could not sell on its own. This support is critical to Air Niugini's ability to achieve sufficient passenger loads and frequency of services on its Australian routes to make widebody aircraft operations viable.

Without the Renewed Codeshare Agreement, Air Niugini would be forced to withdraw from operating widebody aircraft. Among other consequences, this means that Papua New Guinea would lose its only source of commercial air freight services. As described throughout this submission, the negative consequences of this for Air Niugini and the loss of benefit to Papua New Guinean business and consumers would be substantial.

Air Niugini therefore seeks authorisation to enter into and give effect to the Renewed Codeshare Agreement with Qantas.

³ The Australian High Commission in Port Moresby, who maintain a database of Australians registered as living in PNG, has advised that, based on current numbers registered, they estimate there are between 7,000 and 10,000 Australian expatriates currently living in PNG. Though the Australian High Commission records do not extend back to the late 1980's / early 1990's, they have confirmed that they believe an estimate of up to 25,000 Australian expatriates living in PNG at this time seems reasonable. The Australian High Commission has also advised Air Niugini that in 1995, the Consular Office issued approximately 18,000 visitor visas in PNG for entry into Australia. By 2004, this had declined to 10,500, though it recovered slightly to 13,000 in 2006.

4. SUMMARY OF THE CODESHARE AGREEMENTS

The Current Codeshare Agreement commenced on 1 September 2002 for a term of five years, expiring on 31 August 2007. Key terms of both the Current Codeshare Agreement and the proposed Renewed Codeshare Agreement are as follows:

- (a) Air Niugini operates services between Papua New Guinea and Australia on the following routes:
 - (i) Port Moresby - Cairns vv (**Cairns Route**)
 - (ii) Port Moresby - Brisbane vv (**Brisbane Route**)
 - (iii) Port Moresby – Brisbane - Sydney vv (**Sydney over Brisbane Route**).

[CONFIDENTIAL INFORMATION DELETED]

These services are referred to collectively in this submission as the **codeshare services**.

- (b) Qantas is allocated blocks of seats for sale to Qantas passengers on each codeshare service. Most of these seats are allocated on the basis that they must be paid for by Qantas whether Qantas sells them to a passenger or not (the **Hard Block** allocation). The hard block allocation that Qantas is required to purchase under the codeshare arrangements is significantly higher than the number on average that it sells. Unsold hard block seats represent an absolute loss to Qantas. Qantas therefore has a strong incentive to market these seats aggressively in competition with Air Niugini.
- (c) If Qantas sells all of its hard block allocation on any particular flight, it has an option to purchase a certain number of additional seats. This is referred to as the **Soft Block** allocation.
- (d) Air Niugini and Qantas each sells and markets fares on each codeshare service independently though its respective sales networks in full competition with the other. Each carrier has complete freedom in relation to the fare classes it offers, the rules it sets for each class and the prices it charges for fares.
- (e) Qantas is also allocated [CONFIDENTIAL INFORMATION DELETED] of the total aircraft freight capacity on Brisbane and Sydney Routes. All freight allocations are on a hard block basis (ie, Qantas must pay for its full allocation, whether it fills it or not). The codeshare arrangements do not include freight capacity on the Cairns Route, as this service is operated with a Fokker F-100, a narrow-bodied aircraft which cannot carry containerised freight.
[CONFIDENTIAL INFORMATION DELETED]

- (f) Details of the codeshare services and the hard block and soft block passenger and freight allocations on each as at the date of this application are set out in Annexure A.
- (g) Details of the codeshare services and the hard block and soft block passenger and freight allocations proposed under the Renewed Codeshare Agreement have not been finalised. Air Niugini's best estimate of what those services and allocations are likely to be, based on current discussions between the parties, is set out at Annexure B.

PART C - THE FUTURE WITH AND WITHOUT THE CODESHARE AGREEMENT

5. OVERVIEW

When assessing the effect on competition and the public benefits associated with the Renewed Codeshare Agreement, it is necessary to consider and compare the likely outcomes if authorisation is granted and the Renewed Codeshare Agreement proceeds with the likely outcomes if authorisation is not granted and the Renewed Codeshare Agreement does not proceed.

6. IF AUTHORISATION IS GRANTED

If the Renewed Codeshare Agreement is authorised, Air Niugini's codeshare services will be likely to remain viable for at least the term of the Renewed Codeshare Agreement.

As a result of the increased utilisation of the B767 made possible by the codeshare, it is likely that Air Niugini will be able to continue to operate this aircraft viably. As a result, for at least the term of the Renewed Codeshare Agreement:

- (a) Both Qantas and Air Niugini will continue to be able to offer consumers high quality, high frequency jet passenger services between Australia and Papua New Guinea in accordance with the schedule outlined in Annexure B;
- (b) Both Qantas and Air Niugini will continue to be able to offer customers high frequency containerised air freight services between Australia and Papua New Guinea in accordance with the schedule for the B767 operations outlined in Annexure B;
- (c) **[CONFIDENTIAL INFORMATION DELETED]**
- (d) Qantas and Air Niugini will continue to compete in relation to both the prices and terms they offer on both passenger and freight services between Australia and Papua New Guinea; and
- (e) Air Niugini will continue to be able to offer air freight services between Papua New Guinea and countries such as Japan, Singapore, Hong Kong and the Philippines.

7. IF AUTHORISATION IS NOT GRANTED – AIR PASSENGER SERVICES

7.1 Anticipated Qantas response

If the Renewed Codeshare Agreement is not authorised, Air Niugini will cease codeshare arrangements with Qantas.

It is possible that Qantas may withdraw from the market. For example, there is a real potential that Qantas may consider Papua New Guinea a high risk destination for their aircraft and staff, and therefore decide to withdraw services from the market altogether. If this were to occur, the result would clearly be a lessening on competition resulting from the loss of Qantas' marketing presence in the Australia Air Passenger Market.

Air Niugini expects, however, that Qantas would respond by recommencing operation of its own services between Papua New Guinea and Australia. Those services might be Qantas services or, alternatively, some or all services may be offered by Qantas' subsidiary, Jetstar.

In either case, Qantas would face the same problem as Air Niugini – without support from a codeshare partner, demand between Australia and Papua New Guinea is not sufficient to support high frequency widebody air services. Qantas would therefore face a choice in the services it offers – it could offer a low frequency service using widebody aircraft, or it could offer a more frequent service (possibly daily) using a narrowbody aircraft.

As a result of the increased aircraft utilisation made possible by the Current Codeshare Agreement, consumers in Papua New Guinea have come to expect high frequency jet services to Australia. Given these expectations, Qantas would be perceived as uncompetitive if it were to offer a service with significantly less than daily frequencies. Accordingly, in order to achieve frequencies in the order of 6 services per week, Air Niugini expects that Qantas would recommence services using narrowbody aircraft - either Boeing 737s (for a Qantas service) or Airbus 320-200s (for a Jetstar service).

Even so, the introduction of such a service would still introduce substantially more capacity to the market than that lost to Qantas under the codeshare. For example, Air Niugini believes the most likely scenario is that Qantas would introduce at least 6 Boeing 737-800 services per week operating between Brisbane and Port Moresby. This would represent introduction of total capacity of over 52,000 extra seats per annum in each direction⁴ on a route that has a current operated capacity of 87,000 seats per annum⁵. In

⁴ Typical seating capacity of a Qantas 737-800 in international configuration is 168 passengers. Operating 6 services per week, times 52 weeks per year equals capacity of 52,416 seats in each direction

⁵ Current capacity of direct services (ie, excluding travel via Cairns) operated between Port Moresby and Brisbane is calculated as follows:

| | |
|---|---------------|
| Air Niugini (1,494 seats in each direction per week (see Annexure A) x 52 weeks) | 77,688 |
| Airlines PNG (3 services each direction per week with 60 seat 737-200 x 52 weeks) | <u>9,360</u> |
| Total current capacity (direct services) BNE to POM per year: | <u>87,048</u> |

other words, the most likely result of Qantas' seeking to establish itself with an attractive service on this route would be an increase in capacity on the Brisbane route of approximately 60%. Even if capacity on the Sydney Route is taken into account, the Qantas service would still amount to an increase in total capacity of 47%⁶.

If Qantas were to commence services in its own right between Cairns and Port Moresby, Air Niugini anticipates that these services would be provided using de Havilland Dash 8 or, possibly, Boeing 737 aircraft.

7.2 Air Niugini response – short term

Sydney Route

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As shown at Annexure D the current Sydney Route, which is operated as an extension to Brisbane Route, is already highly unprofitable. Without codeshare support, it would make even greater losses than it does currently.

Accordingly, if the Renewed Codeshare Agreement were not to be authorised, Air Niugini would cease to offer the Sydney Routes, and would instead only offer Brisbane and Cairns Routes.

Brisbane Route

Air Niugini would lose the contribution towards operating costs of its B767 Brisbane Route that is currently provided by the codeshare payments received from Qantas for its allocation of seats under the codeshare agreement.

In addition, as described in section 7.1 above, in order to provide a jet service with the level of frequency that consumers in Papua New Guinea have come under the Current Codeshare Agreement to expect, Qantas would have to increase total capacity in the market by almost 60%. In the short term, this would result in price reductions and a battle for market share as each carrier struggled to attract sufficient customers to make its schedules viable.

⁶ Current capacity of direct services (ie, excluding travel via Cairns) operated between Port Moresby Brisbane and Sydney is calculated as follows:

| | |
|--|----------------|
| Air Niugini (1,494 + 468 seats in each direction per week (see Annexure A) x 52 weeks) | 102,024 |
| Airlines PNG (3 services each direction per week with 60 seat 737-200 x 52 weeks) | <u>9,360</u> |
| Total current capacity (direct services) BNE & SYD to POM per year: | <u>111,384</u> |

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

- (a) Qantas has access to more substantial marketing resources than Air Niugini;
- (b) Qantas is large network carrier. It is therefore able to offer customers discounts on a wide network of routes throughout Australia and, through its broader international network and its “OneWorld” alliance membership, throughout the world. Air Niugini is unable to match such offers;
- (c) Air Niugini expects that Qantas would terminate its reciprocal frequent flyer points agreement with Air Niugini, denying Air Niugini access to this useful marketing tool; and
- (d) [CONFIDENTIAL INFORMATION DELETED]

All of these factors mean that, in a world without the Renewed Codeshare Agreement, Air Niugini’s B767 operations between Papua New Guinea and Australia would incur substantial losses. As shown at Projection D at Annexure C, if Air Niugini were to participate in this battle by maintaining its current level of frequencies, this would be likely to result in Air Niugini’s Brisbane Route incurring losses in the order of [CONFIDENTIAL INFORMATION DELETED] per year. Overall, as shown at Projection A compared with Projection B, the profitability of Air Niugini’s B767 aircraft would decrease by over [CONFIDENTIAL INFORMATION DELETED] per year.

In these circumstances, Air Niugini simply does not have the financial resources to “tough out” a sustained battle for market share with Qantas.

In the short term, Air Niugini’s aircraft lease commitments mean it would be likely to have no alternative but to continue operate widebody B767 services. In order to minimise its losses, however, Air Niugini would have to substantially reduce the number of services it would operate on codeshare routes. Air Niugini therefore believes that it would be likely to have to reduce its B767 operations from six per week to two or three, concentrated on the strongest traffic days of Monday, Friday and, possibly, Sunday.

As shown in Projection C at Annexure C, this would still be likely to result in losses for Air Niugini’s widebody aircraft operations in the order of [CONFIDENTIAL INFORMATION DELETED] per year. Overall, as shown by comparing Projection A with Projection C, the profitability of Air Niugini’s B767 aircraft would still be more than [CONFIDENTIAL INFORMATION DELETED] less per year than if the Renewed Codeshare Agreement were authorised.

Cairns Route

Under the Current Codeshare Agreement, Air Niugini has been able for the first time to provide a high frequency jet service to Cairns. If the Renewed Codeshare Agreement is not authorised, the frequency of this service will need to be reduced and some or all these

services will need to revert to smaller “Dash 8” aircraft, with a resultant loss of speed and comfort for travellers.

7.3 Air Niugini response – medium to long term

As noted above, for at least some time, Air Niugini would have little alternative but to try to “tough it out” with continued widebody B767 operations between Papua New Guinea and Australia. However, it would be an unjustifiable drain on national resources for Air Niugini to continue to sustain losses of in the order of [CONFIDENTIAL INFORMATION DELETED] per year on an ongoing basis.

In the absence of a codeshare with Qantas on routes between Papua New Guinea and Australia, Air Niugini believes that the only way it could continue to provide a range of international services whilst avoiding or minimising losses would be to negotiate with the lessors of the B767 to be released from its lease of this aircraft.

[CONFIDENTIAL INFORMATION DELETED]

Air Niugini would then replace its B767 with one of the few narrowbody aircraft with sufficient range to service Air Niugini’s international destinations, such as an Airbus A319ER, or a long range version of Boeing’s 737.

8. IF AUTHORISATION IS NOT GRANTED – AIR FREIGHT SERVICES

8.1 Short term

Qantas

For reasons described in section 7 above, Air Niugini expects that Qantas would commence its own services between Australia and Papua New Guinea with narrowbody aircraft. Since narrowbody aircraft are unable to carry containerised freight, Qantas would be forced to substantially withdraw from the provision of air freight between Papua New Guinea and Australia.

Air Niugini

Due to Air Niugini’s aircraft lease commitments, it would have no alternative in the short term but to continue to operate widebody services between Papua New Guinea and Australia.

Air Niugini would therefore continue for a period to offer air freight services, and would face little or no competition in the provision of these services. The total capacity of air freight services available and the frequency of those services would be substantially reduced compared to the services be able to be offered if the Renewed Codeshare Agreement were authorised.

8.2 **Medium to long term**

As described in section 7 above, in the medium to long term, without codeshare support Air Niugini will be forced to replace its B767 with a narrowbody aircraft.

Since narrowbody aircraft cannot carry containerised freight, Air Niugini would be forced to substantially withdraw from the provision of air freight. Air Niugini would therefore cease to provide air freight services between Papua New Guinea and any of Australia, Japan, Hong Kong, Singapore or the Philippines.

In the Australian Air Freight Market, there would be two potential market results from the withdrawal of Air Niugini from the provision of containerised air freight services:

(a) Papua New Guinea may be forced to rely on dedicated freighters

The economics of international air services are driven primarily by passenger demands, not freight demands. Qantas' passenger demand between Papua New Guinea and Australia would be more than adequately served for the foreseeable future by narrowbody aircraft. It is therefore possible that Qantas may not replace any of the air freight capacity lost as a result of the withdrawal of Air Niugini's widebody services.

It is likely that at least some of this lost air freight capacity between Australia and Papua New Guinea would be replaced by the entry to the market of dedicated freighter aircraft. However, for reasons explained in section 13.2, such freight services would inevitably be higher cost and lower frequency than the services currently provided by Air Niugini and Qantas pursuant to the codeshare services.

(b) Qantas may take the opportunity to be the primary freight provider

Alternatively, it is possible that Qantas may elect to use a widebody aircraft for one or more of its Papua New Guinea services. This would provide at least some widebody capacity to Papua New Guinea.

If Qantas were to price its freight services at a sufficiently high level, this capacity might also be supplemented by the entry of some dedicated air freighter capacity.

It is unlikely that any carrier would replace any of the air freight capacity lost as a result of Air Niugini's withdrawal of air freight services between Papua New Guinea and any of Japan, Singapore, Hong Kong or the Philippines.

PART D - COMPETITION ANALYSIS

9. RELEVANT MARKETS AND APPROACH TO MARKET DEFINITION

Air Niugini submits that the relevant passenger market affected by the Renewed Codeshare Agreement is the market for passenger air services between Papua New Guinea and Australia (the **Australia Air Passenger Market**).

The relevant freight markets affected are:

- (a) the market for the provision of air freight services between Papua New Guinea and Australia (the **Australian Air Freight Market**); and
- (b) relevantly defined markets for air freight services between Papua New Guinea and other international destinations currently serviced by Air Niugini's B767 (the **Asian Air Freight Markets**),

(together, the "**Air Freight Markets**").

It is unlikely that the Renewed Codeshare Agreement could have a material adverse effect on competition in the markets for ancillary services such as for the supply of engineering and maintenance services. If, however, the ICCC considers that further consideration of these ancillary markets is required, Air Niugini would be pleased to provide further information.

The approach adopted by Air Niugini in adopting these market definitions is set out in Annexure E to this submission.

10. COMPETITION IN AIR PASSENGER MARKET – WITH CODESHARE

10.1 Overview

The current structure in the Australia Air Passenger Market is both effective and efficient. It provides Papua New Guinea with –

- (a) through the Qantas Air Niugini Codeshare Arrangements, a carrier with the size necessary to achieve efficiencies of scale and offer consumers high capacity, high quality and high frequency air passenger services,

combined with
- (b) through Airlines of PNG and low barriers to entry, sufficient competitive constraints to ensure that Air Niugini and Qantas are not able to charge consumers, supra-competitive prices or compromise the services they offer to consumers in any way.

A range of factors show that the arrangements provide effective competition for the benefit of consumers in both Papua New Guinea and Australia. These are described in more detail below.

10.2 **Pro-competitive codeshare structure**

A codeshare is an arrangement where one airline (the **marketing carrier**) buys seats on a flight operated by another airline (the **operating carrier**) to sell to the marketing carrier's customers. Codesharing is an important form of airline competition. In the modern aviation industry, codesharing has become common, with recognised potential for delivering a lower seat cost to the operator and lower airfare to the travelling public. Many governments entering into Air Service Agreements around the world recognise and endorse codesharing.

Qantas operates in a more mature and developed market than Air Niugini and yet still relies significantly on codeshare capacity. Air Niugini understands that Qantas currently participates in at least 20 codesharing agreements over various routes on its network, and there are currently hundreds of codesharing agreements among the world's airlines. A survey of the myriad of codesharing and alliance arrangements implemented around the world is set out in Airline Business' *Airline Alliance Survey 2006*, a copy of which is attached at Annexure H.

Codeshare arrangements typically fall into two broad types:

- (a) 'hard block'; or
- (b) 'free sale'.

Under a free sale codeshare, the marketing carrier only pays the operating carrier for seats if it actually sells them.

By contrast, under the Qantas Air Niugini codeshare arrangements, Qantas is allocated blocks of seats for sale on each codeshare service. Most of these seats are allocated on a 'hard block' basis. This means they must be paid for by Qantas whether Qantas sells them or not. This is recognised by competition regulators around the world as the most competitive form of codesharing arrangement.

Under the codeshare arrangements, Air Niugini and Qantas each sells and markets fares on codeshare services independently, in full competition with the other.

Each carrier, independently from the other:

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

The number of seats Qantas must purchase in its hard block allocation is, on average, significantly higher than the number of seats it normally sells. Once Qantas has entered into the Renewed Codeshare Agreement and committed to purchase its hard block allocations, each seat on each codeshare service sold by Qantas effectively has a marginal cost of zero kina. Unsold hard block seats therefore represent an absolute loss to Qantas.

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

10.3 **Effective competition between the parties**

The structure of the codeshare arrangements results in effective competition for sales on codeshare services between Qantas and Air Niugini.

The effectiveness of this competition is shown by the fact that **Air Niugini's average yields have, in real terms, reduced on every codeshare route over the course of the Current Codeshare Agreement.** This is illustrated in Table 1 and

Figure 2, Figure 3 and Figure 4 below. (In each figure, the line graph shows the unadjusted average return fare across all cabins and the bar graph shows average return fare across all cabins adjusted for changes in Papua New Guinea All Groups CPI.)

Table 1: Air Niugini yield by route - average return fare, all cabins

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Figure 2 – Cairns Route Air Niugini average yield for all cabins

[CONFIDENTIAL INFORMATION DELETED]

Figure 3 - Brisbane Route Air Niugini average yield for all cabins

[CONFIDENTIAL INFORMATION DELETED]

Figure 4- Sydney Route Air Niugini average yield for all cabins

[CONFIDENTIAL INFORMATION DELETED]

The effectiveness of competition in the Australia Air Passenger Market is also reflected in the changes in market shares over the life of the Current Codeshare Agreement. As shown in Table 2, far from being stable (which would be expected in a market with a low degree of active competition), market shares have changed substantially from year to year as each market participant has jostled to win market share from the others.

Table 2: Australia Air Passenger Market Shares 2003 - 2006⁷

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⁷ No official market share data is available in Papua New Guinea. Market shares are therefore calculated on the basis of Air Niugini estimates of passengers carried by Airlines of PNG

10.4 No constraining of capacity

As with many markets, competition in airline markets is driven substantially by capacity. The higher the level of capacity relative to demand, the higher the pressure on prices. Competition regulators have therefore raised concerns where codeshare arrangements have the effect of constraining capacity on a route.

Graphical summaries of the average overall load factors achieved on each codeshare route over the life of the Current Codeshare Agreement are set out at Figure 5, Figure 6 and Figure 7 below. A complete listing of passenger numbers and load factors on a month by month basis for each carrier over the life of the Current Codeshare Agreement is set out at Annexure F. These all show clearly that the codeshare arrangements have not had the effect of constraining capacity on any codeshare routes in any way.

Figure 5: Average load factor – Brisbane Route

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Figure 6: Average load factor – Sydney Route

[CONFIDENTIAL INFORMATION DELETED]

Figure 7: Average load factor – Cairns Route

[CONFIDENTIAL INFORMATION DELETED]

10.5 Other competitors

In addition to competition between themselves, Air Niugini and Qantas face effective competition in the Australia Air Passenger Market from both Airlines of PNG, and from the ability of major customers such as mining companies to charter their own flights to service a substantial proportion of their air transport needs between Papua New Guinea and Australia.

Airlines of PNG

Airlines of PNG commenced international operations between Cairns and Port Moresby in November 2005, operating 5 weekly services with de Havilland Dash 8-100 aircraft. This was quickly increased to 6 services per week and, from November 2006, to 7 services per week. Airlines of PNG announced its intention to operate between Brisbane and Port Moresby early in July 2006 with a leased Boeing 737-200, and commenced this service in 21 August 2006. This service was initially run twice weekly. From November 2006, this was increased to thrice weekly.

As shown in Table 2, Air Niugini estimates that Airlines of PNG has already captured over 8% of the Australia Air Passenger Market. Although this is, as yet, a relatively modest market share, it represents substantial and aggressive growth for a carrier that has entered the market so recently. When combined with the absence of barriers to entry or expansion in the Australia Air Passenger Market (see 10.6 below), this suggests that Airlines of PNG will have a powerful effect in competitively constraining both Air Niugini and Qantas during the term of the Renewed Codeshare Agreement.

When approving the proposed Trans-Tasman alliance between Qantas and Air New Zealand, the Australian Competition Tribunal summarised the ability of a small but vigorous competitor to constrain the conduct of a much larger competitor as follows:

[A]lthough market share can be a significant factor in determining the extent of competition in a market, we believe that prime attention must be paid to market conduct. A structuralist approach that focuses heavily on an increase of market power by using market shares as a proxy to assess market power fails to assess the whole picture.....

Market shares, by themselves, in the absence of barriers to entry or expansion, do not guarantee that the firms holding such market positions will be able to act to the detriment of the competitive process. A high market share indicates only that at a point of time the firm in question has been able to command the patronage of many customers in the market. Such patronage may be due to the fact that the firm has been able to offer the right “price-product-service package” to customers...

... [w]hen entry barriers are low or non-existent, in the sense that there exist no impediment to competitively significant entry – entry that will serve to constrain the firm in question - then if the firm currently enjoys a high share of the market, this will not of itself signal that the firm can be expected in the future to behave in an anti-competitive manner.

Airlines of PNG has shown itself to be a competitor with the determination and resources to compete effectively in the Australia Air Passenger Market. The company has targeted both leisure passengers, with aggressively priced leisure fares, and business passengers, with a range of business oriented promotions. For example, Airlines of PNG has:

- targeted Air Niugini corporate customers in both Papua New Guinea and Australia, with particular emphasis on targeting Air Niugini’s customers in the mining sector.
- targeted the adventure market, offering aggressively priced fares to wholesalers of Kokoda trekking and dive holidays.
- offered businesses incentives such as “buy 5, get 1 free” and “buy 10, get 1 free”; and
- offered travel agents and managers incentives such as with free tickets for consultants for every 50 commercial bookings made.

Although Air Niugini has responded to competition from Airlines of PNG it is important to note that, in doing so, it has been careful not to engage in conduct that may be considered predatory. Air Niugini has introduced new discounted fares to compete with the discounts offered by Airlines of PNG. Those discounted fares, however, respond to prices offered by Airlines of PNG rather than attempting to force prices down further. Air Niugini has not undercut Airlines of PNG nor engaged in any conduct aimed at forcing Airlines of PNG to withdraw from the market or behave in a less competitive way.

Ability of customers to charter their own flights

Air Niugini and Qantas are also constrained by the ability of major customers to impose price pressure by threatening to or actually chartering or operating their own services between Papua New Guinea and Australia.

For example, Lihir Gold Ltd recently sought airline proposals for Cairns / Lihir / Cairns charters to operate six flights per week to cater for between 55-70 passengers per week in each direction. Airlines of PNG was awarded the contract on the basis of using a Dash 8-100 aircraft which they have reconfigured especially to 12 business seats only.

10.6 Low barriers to entry and potential competitors ready to enter

In addition to being constrained by existing competition, Air Niugini and Qantas are at all times constrained in their conduct by the fact that barriers to entry to the Australian Air Passenger Services Market are low. If Air Niugini or Qantas were to raise prices or reduce service levels, it would be easy for a new entrant to take advantage of this to enter the market.

A summary of the reasons why barriers to entry to the Australian Passenger Air Services Market are low is set out below:

- No regulatory barriers. There is more than adequate capacity available under the air services agreement between Papua New Guinea and Australia to allow either a new Australian or Papua New Guinean carrier to enter any or all of the codeshare routes, and both countries allow multiple carrier designation. Relevant safety certificates for operation in Australia and Papua New Guinea are available to any carrier that satisfies fair and objective safety standards.
- No slot constraints. There are no slot constraints at any of Port Moresby, Cairns, Brisbane or Sydney airports that would be likely to hinder the entry of a new carrier on any of the codeshare routes.
- Ground facilities are available. Ground handling facilities and common user terminals are readily available at all airports relevant to any of the codeshare routes.
- Aircraft are available. There is an active international market for appropriate aircraft. This means that a new entrant could acquire appropriate aircraft at competitive prices. Sunk costs are minimal, as aircraft can be readily resold. Alternatively, if a new entrant wanted to minimise start up capital requirements, active markets exist to enable them to lease appropriate aircraft with minimal capital outlay.

This ability for new carriers to enter the Australian Passenger Air Services Market is illustrated by the recent entry to the market and rapid expansion of Airlines of PNG, which has been described in more detail above.

In addition:

- (a) Pacific Blue (Virgin Blue's international subsidiary) is well positioned to enter this market at short notice. Pacific Blue is actively seeking to expand its operations in the Pacific region. It is well resourced, holds all necessary certifications for market entry, has an established and respected name and reputation, and has a fleet of aircraft that would be well suited to operations on routes of this type;

- (b) The Commission noted in September last year its report entitled *Papua New Guinea Tourism Sector Review and Masterplan 2007-2017* that there were then suggestions of a further new entrant on the Port Moresby and Cairns route⁸;
- (c) A range of other companies, such as the newly established Tiger Airways Australia (which has financial backing from the Singapore government and has been investigating potential routes in the north of Australia), may also be well position to enter the market if Air Niugini and Qantas were to raise prices to make more than normal levels of profit.

11. COMPETITION IN AIR PASSENGER MARKET – NO CODESHARE

If the Renewed Codeshare Agreement is not authorised, Air Niugini expects that Qantas would commence its own services in the Australia Air Passenger Market. For reasons described in section 7.2, this would be likely to trigger a short term price and capacity battle as each carrier fought to attract sufficient passengers to make its services viable.

In the longer term, it is a foregone conclusion that the result of such a battle could only be that Air Niugini would need to withdraw capacity to become a smaller, less significant operator on codeshare routes. Though Air Niugini is aware of this, its lease obligations mean that, for a period, it would have no alternative but to continue to operate its widebody B767 on the codeshare routes. During this period, to minimise its losses, it would have to fight to attract what customers it could to cover at least the marginal costs of its widebody operations.

This means that, until Air Niugini could withdraw from widebody operations and reduce its costs by substituting a narrowbody aircraft on the codeshare routes, average fares on the routes would be likely to fall below a level that would be sustainable for term operations.

Such a price war may provide consumers with a period of benefit, but those benefits would be short lived.

Air Niugini would be likely to sustain substantial losses. As a national airline, those losses represent a direct loss to the people of Papua New Guinea. Government backing, however, means that Air Niugini would ultimately survive until such time as is could it could stem those losses by withdrawing from widebody operations.

Airlines of PNG has neither the financial resources of Qantas, nor the ultimate government backing of Air Niugini. Air Niugini therefore believes that Airlines of PNG would be unlikely to survive the market restructure that would result from the loss of the current codeshare arrangements. The likely ultimate effect of loss of the codeshare on the structure of the Australia Air Passenger Market can therefore be summarised as follows:

⁸ at P71

| | Operating carriers | Marketing carriers | Efficiencies |
|-----------------------------|---|------------------------------------|---|
| With codeshare | 2 – One large (PX/QF) and one smaller (Airlines of PNG) | 3 – QF, PX and Airlines of PNG | Achieve efficiencies of combining traffic on B767 |
| Without codeshare | 2 – One large (QF) and one smaller (PX) | 2 – QF and PX | All or most capacity narrowbody |
| Effect of loss of codeshare | Nil | loss of 1 marketing carrier | loss of efficiencies of B767 |

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

12. COMPETITION IN AIR FREIGHT MARKETS – WITH CODESHARE

12.1 Overview

The use of a widebody aircraft on its international routes provides Air Niugini with more than ample capacity to service the needs of Papua New Guinea. These services are frequent and efficient.

Both the Current Codeshare Agreement and the proposed Renewed Codeshare Agreement oblige Qantas to purchase half of Air Niugini’s available air freight capacity on widebody codeshare services. The Renewed Codeshare Agreement therefore provides for the continuation of two carriers with the ability and incentives to sell high quality air freight services in the Australian Air Freight Market in competition with one another.

A summary of the quantities and shares of air freight sold on codeshare services by each of Qantas and Air Niugini over the term of the Current Codeshare Agreement is set out at Annexure G. This data illustrates the following:

- (a) The high frequency widebody services on codeshare routes made possible by the codeshare provides significantly more air freight capacity than necessary to meet demand in the Australian Air Freight Market. This excess capacity provides strong incentives to the parties to price their air freight services competitively.
- (b) In particular, although Qantas is required to purchase and pay for **[CONFIDENTIAL INFORMATION DELETED]** of all available air freight capacity on all widebody codeshare services, on average it achieves less than 50% utilisation of this capacity. Qantas therefore has substantial incentive to compete vigorously to sell its share of air freight capacity in competition with Air Niugini.

- (c) These incentives are borne out in practice. This can be seen from the relative shares of sales which vary between the parties substantially from year to year as each party competes to win customers from the other.

Average freight yields achieved by Air Niugini on codeshare routes are shown in Table 3 below. As shown in that table, there has been growth in average freight yields over the course of the Current Codeshare Agreement. Factors contributing to this include the following:

- A recovery in activity in the mining industry and consequent demand for delivery of mining equipment has driven higher loads and yields.
- Yield mixes have changed over the life of the Current Codeshare Agreement, with higher proportions of general cargo displacing perishable cargo. Since perishable cargo (eg, fruit) typically has a lower yield than general cargo, this change in mix has led to an improvement in average yields.
- Depreciation in the Kina from 2002 to 2003 increased a range of Kina denominated prices.

Table 3: Average air freight yields in Australian Air Freight Market

[CONFIDENTIAL INFORMATION DELETED]

12.2 Low barriers to entry and potential competitors ready to enter

As with the Australian Passenger Air Services Market, barriers to entry to the Australian Air Freight Market are low.

- No regulatory barriers. There is more than adequate freight capacity available under the air services agreement between Papua New Guinea and Australia to allow either a new Australian or Papua New Guinean carrier to enter any or all of the codeshare routes, and both countries allow multiple carrier designation.
- No slot constraints. There are no slot constraints at any of Port Moresby, Cairns, Brisbane or Sydney airports that would be likely to hinder the entry of a new carrier on any of the codeshare routes.
- Ground facilities are available. Freight ground handling facilities are available at all airports relevant to any of the codeshare routes. Alternatively, there is no

shortage of space at Jackson's International airport for competitive carriers to build their own freight handling facilities.

- Aircraft are available. There is an active international market for appropriate aircraft. This means that a new entrant could acquire appropriate aircraft at competitive prices. Sunk costs are minimal, as aircraft can be readily resold. Alternatively, if a new entrant wanted to minimise start up capital requirements, active markets exist to enable a new entrant to lease appropriate aircraft with minimal capital outlay.

A range of companies, such as Hevilift would be readily able to commence freight operations between Australian and Papua New Guinea if prices charged by Air Niugini and Qantas were to rise above competitive levels.

13. COMPETITION IN AIR FREIGHT MARKETS – NO CODESHARE

13.1 Short term

As described at section 8, if the Renewed Codeshare Agreement were not authorised:

- (a) Air Niugini would continue for a period to offer widebody air freight services. The frequency of those services and total air freight capacity therefore made available in the Australian Air Freight Market, however, would be substantially reduced compared to the frequencies and total capacity available if the Renewed Codeshare Agreement were authorised; and
- (b) Qantas would be forced to substantially withdraw from the provision of air freight between Papua New Guinea and Australia.

This means that, in the short term, Air Niugini would be likely to be the only substantial supplier of air freight services in the Australian Air Freight Market. Clearly, the short term effect of loss of the codeshare would therefore be a substantial lessening of competition in this market.

13.2 Medium to long term

As described at section 8, in the longer term, if the Renewed Codeshare Agreement were not to be authorised the likely outcomes would be either:

- (a) Papua New Guinea would be forced to rely on the entry of dedicated air freighters to service the nation's air freight needs; or
- (b) Qantas may possibly take the opportunity to become the primary air freight provider to Papua New Guinea by electing to use a widebody aircraft for one or more of its Papua New Guinean services. This would provide at least some widebody capacity to Papua New Guinea.

For the reasons set out below, the result in either case would be a substantial lessening of competition compared to the position if the Renewed Codeshare Agreement were authorised.

In comparison with freight carried in the bellyhold of widebody air passenger services, dedicated freighter operations suffer the following disadvantages:

- (a) Because the costs of each flight can be allocated across passenger services as well as freight services, freight carried in the bellyhold of passenger aircraft can be provided at a much lower cost than possible with dedicated 'freight only' services.
- (b) Papua New Guinean air freight flows are directional, with greater volumes of freight carried north from Australia to Papua New Guinea than south from Papua New Guinea to Australia. A dedicated freighter must therefore price its freight at a level sufficient to make up for having a lower load factor on the southbound leg of each service. This problem does not affect a widebody passenger based service in the same way because the costs of such a service are largely underwritten by passenger revenue, which is much less directional⁹.
- (c) A dedicated freighter must also operate a much lower frequency of service than a widebody passenger based service because, unlike the passenger based service, a dedicated freighter must wait to fly until it anticipates it hold will be full or close to full.

As a result, the provision of air freight services by dedicated freighter operations would lead to higher prices and lower frequencies of service compared to the position if the Renewed Codeshare Agreement were authorised.

Air Niugini calculates that, in order to be viable, a dedicated freighter would have to recover an average of at least AUD3.50/kg for air freight in each direction between Australia and Papua New Guinea¹⁰. By contrast, as at the date of this submission, Air Niugini's average yields on freight services in the Australia Air Freight market were just [CONFIDENTIAL INFORMATION DELETED].

For the following reasons, the position is not much better if Qantas were to introduce at least some widebody capacity to the market:

1. The level of capacity potentially supplied to the market by Qantas would be a fraction of the capacity supplied to the market if high frequency widebody services

⁹ ie, because, over time, nearly all passengers travel on a return basis.

¹⁰ This estimate assumes the use of a B737 freighter with an operating cost of AUD28,500 per block hour, achieving average freight load factors of 78% and applying a mark up on direct operating costs of just 30% to cover all management and overhead costs and return on capital. In practice, it is likely that these estimates may be overly aggressive and actual charges required to establish a viable freighter business may be significantly higher

were to continue¹¹. Pressure on Qantas to price its services competitively would therefore be much less than if the Renewed Codeshare Agreement were authorised; and

2. Without competition from Air Niugini, the only constraint on Qantas' ability to raise air freight prices would be the prices able to be charged by dedicated freighters. As described above, dedicated freighters have a much higher cost structure than widebody passenger based freight services. Qantas would therefore be free to raise freight prices substantially before facing any threat of constraint from dedicated freighters.

Under any potential scenario, therefore, failure to authorise the Renewed Codeshare Agreement would result in lower levels of competition and higher prices in the Australian Air Freight Market than would be the case if the Renewed Codeshare Agreement were authorised.

¹¹ ie, because Qantas could not sustain many of its passenger services being operated with widebody aircraft. At most, one or two frequencies a week would be likely to be operated with widebody aircraft, compared with six frequencies per week under the codeshare. Air Niugini believes even this level of freight capacity is unlikely.

PART E - PUBLIC BENEFITS

14. OVERVIEW

The Air Niugini Qantas codeshare arrangements provide a wide range of public benefits. These include the following:

- (a) Benefits to the Papua New Guinean economy through increasing Air Niugini's foreign earnings;
- (b) Benefits to the Papua New Guinean economy through enabling Air Niugini to earn profits on codeshare routes (rather than the losses that would result without the codeshare) which can be returned to the people of Papua New Guinea through the payment of dividends to the government;
- (c) Provision of cheaper, more frequent and more efficient air freight services;
- (d) More efficient use of resources through allowing the use of widebody aircraft on codeshare routes with lower per passenger costs and lower greenhouse emissions than the duplicated narrowbody services that will result without the codeshare;
- (e) Increased opportunity for direct services to Australia from regional Papua New Guinean airports;
- (f) Provision of more frequent services than either Qantas or Air Niugini could offer on their own;
- (g) Creation of a substantial number of jobs in Papua New Guinea;
- (h) Greater customer comfort through the ability to travel on widebody rather than narrowbody aircraft; and
- (i) A stronger, more capable flag carrier for the nation

These benefits are all described in more detail in the sections below.

15. CONTRIBUTION TO PAPUA NEW GUINEAN GOVERNMENT REVENUES

As a national carrier, Air Niugini returns its profits to the government to use for the benefit of the nation, such as by funding critical welfare and infrastructure projects. If the Renewed Codeshare Agreement is not authorised, Air Niugini calculates that its **overall profitability will be reduced by over K27 million per year** until such time as it is able to

restructure its operations to withdraw from widebody operations¹². These losses represent a direct loss of funds that would otherwise be available to the government to use elsewhere for the benefit of the nation.

Even after Air Niugini is able to withdraw from widebody operations, its profitability (and therefore the funds available to the government for the benefit of the nation in the form of dividends from Air Niugini) is likely to be substantially reduced in comparison with its likely profitability with the support of the codeshare.

16. BENEFITS TO PNG ECONOMY AND BALANCE OF PAYMENTS

Since 2003, the Papua New Guinean economy has enjoyed some degree of recovery from the difficulties days of the late 1990s and early 2000's. However, the road ahead still holds many challenges. Budget deficits and public debt remain high and further reductions in outlays, or increases in revenue, will be required in 2007 and 2008 to meet the PNG Government's Medium Term Fiscal Strategy target.

In this context, the foreign earnings provided by Air Niugini's codeshare arrangements with Qantas are important to the Papua New Guinean economy. Conversely, if Air Niugini is forced through the loss of Qantas codeshare support to withdraw from significant parts of its business, the transfer of revenue to foreign carriers that will result must damage the economy.

Further, with loss of the codeshare, Air Niugini will become a smaller airline with less flying across to spread fixed costs. The result may be to increase the business's break even prices domestically as well as internationally. This may lead to increases in domestic airfares and a reduced ability for the airline to continue to operate loss making or marginal domestic routes which are currently carried out as a community service obligation.

Air Niugini estimates that total direct contribution to Papua New Guinea's balance of payments from authorisation of the Renewed Codeshare Agreement is likely to total over **K610million over the five years of the Renewed Codeshare Agreement**. Some of the components of this benefit are described in more detail below.

16.1 [CONFIDENTIAL INFORMATION DELETED] million benefit to PNG's balance of payments from Qantas codeshare payments.

Air Niugini expects to earn in the order of [CONFIDENTIAL INFORMATION DELETED] million every year from the sale of codeshare seats and freight capacity to Qantas under the Renewed Codeshare Agreement. These sales are, in effect, an export of

¹² Calculated as the difference in projected annual aircraft profitability in 2008 from Projection A (operations with codeshare) in Annexure C, and projected annual aircraft profitability in 2008 from Projection C (operations without codeshare, and with reduced B767 frequencies to reduce losses). If Air Niugini does not withdraw capacity and instead tries to compete with Qantas for market share, the annual losses will exceed **K40m** (ie, comparing aircraft profitability in 2008 from Projection A with aircraft profitability in 2008 from Projection B).

high value services by Air Niugini to Qantas. Loss of the codeshare means these foreign earnings and the benefits they bring to the Papua New Guinean economy will be lost.

16.2 **K150 million benefit to PNG's balance of payments from additional Air Niugini passenger revenues.**

For reasons described in section 7 of this submission, if the Renewed Codeshare Agreement is not authorised then, in addition to losing Qantas' codeshare payments, Air Niugini will lose passenger revenues as a result of the need for Air Niugini to reduce the scale of its operations and the transfer of passengers from Air Niugini services to the foreign owned Qantas services. Over the proposed term of the Renewed Codeshare Agreement, this is likely to amount to **transfer in passenger revenue from the nationally owned Air Niugini to the foreign owned Qantas of over K150million.**¹³

16.3 **[CONFIDENTIAL INFORMATION DELETED] million benefit to PNG's balance of payments from air freight revenues.**

Air Niugini anticipates that, if the Renewed Codeshare Agreement is authorised, its annual earnings from the sale of international air freight services are likely to be in the order of **[CONFIDENTIAL INFORMATION DELETED]** million per year. This equates to revenues of over **[CONFIDENTIAL INFORMATION DELETED]** million over the life of that agreement. If the Renewed Codeshare Agreement is not authorised and Air Niugini is forced to withdraw from this business, this revenue will be likely to flow instead primarily to foreign owned carriers, with consequent impact on Papua New Guinea's balance of payments.

In addition, the air freight services provided by Air Niugini to the nation if the Renewed Codeshare Agreement is authorised will be cheaper and of higher quality than the services likely to be available if the Renewed Codeshare Agreement is not authorised. The benefits of this to the economy are described at section 17 below.

17. AIR FREIGHT

Air freight services enable a nation, regardless of its location, to connect to distant markets and global supply chains in a speedy, reliable manner. This is of particular importance to a remote nation such as Papua New Guinea.

The availability of efficient and frequent air freight services is therefore critical to the growth of Papua New Guinea's economy and the welfare of its people. In addition, the price at which these services can be provided is important for the growth of the economy. Low cost air freight services make Papua New Guinean products more competitive in international markets and increases the profitability Papua New Guinean industry.

¹³ ie, total passenger revenues in over the life of the Renewed Codeshare Agreement from Projection A (operations with codeshare) in Annexure C, less total passenger revenues over the life of the Renewed Codeshare Agreement from Projection C (operations without codeshare, and with reduced B767 frequencies to reduce losses) equals K156,100,070.

Conversely, increases in the cost of air freight make Papua New Guinea less competitive in international markets and impose a cost impost on the whole of the economy.

For reasons set out in sections 8 and 11 of this submission, the likely result for air freight services from loss of the Qantas codeshare would be as follows:

1. In the short term, there would be a loss of air freight capacity and frequency in the Australian Air Freight Market as Air Niugini would be forced to reduce its B767 frequencies on codeshare routes.
2. In the medium to long term, this loss of air freight capacity and services in the Australian Air Freight Market would be compounded by inevitable price increases as Air Niugini would be forced to withdraw from the market and the nation would become dependent instead on higher cost freighter services.
3. In Asian Air Freight Markets, Papua New Guinean industry and consumers would lose the direct air freight services currently provided by Air Niugini's widebody services. All air freight to or from anywhere in the world would have to travel to Papua New Guinea via Australia. Instead of being able to ship products direct from Papua New Guinea to Asian markets, exporters would first have to pay an increased price to freight their goods to Australia, and then pay a further amount to forward their freight from Australia to their ultimate destination. This would substantially increase both the cost and travel time for all of Papua New Guinea's air freight needs.

These price increases and losses of service would affect nearly all consumers and industry in Papua New Guinea. Perishable and high value commodities used throughout the economy are imported to Papua New Guinea in the bellyhold of Air Niugini's widebody services. On the export side, important industries such as Papua New Guinea's fishing industry depend heavily for their export earnings on the availability of competitive international air freight services. Products that that would be particularly affected by price increases and service reductions in air freight markets include the following:

17.1 **Tuna**

According to the National Fisheries Authority, the export value of tuna is currently K200 million¹⁴, with the major markets for fresh chilled tuna being Japan and Australia.

In the last year alone, Air Niugini carried [CONFIDENTIAL INFORMATION DELETED]kgs of tuna on its direct flights to Japan.

The annual tuna catch is currently about 150,000mt to 200,000mt, but it is estimated that the resource can sustain much higher annual catches of 250,000mt to 300,000mt.¹⁵ The

¹⁴ National Fisheries Authority, Papua New Guinea "PNG Fisheries – Tuna", available at: http://www.fisheries.gov.pg/fisheries_tuna.htm

¹⁵ National Fisheries Authority, Papua New Guinea "PNG Fisheries – Tuna", available at: http://www.fisheries.gov.pg/fisheries_tuna.htm

potential market value is about K1 billion depending on the commodity price.¹⁶ Realising the benefit of this catch for the Papua New Guinea economy, however, depends on the availability of competitive international air freight services.

17.2 Prawns

Over K13 million worth of prawns is currently caught in Papua New Guinea per annum. The prawns are mainly exported to Japan, Singapore and Australia, with some also being sold domestically within Papua New Guinea.¹⁷ The loss of direct freight services to Singapore and Japan would be very damaging for this industry.

17.3 Barramundi

According to the National Fisheries Authority, in 2002, 31.5 tonnes of barramundi, valued at around K600,000 thousand were exported.¹⁸ In 2003, 10.6 tonnes of barramundi valued at around K230,000 were exported. Again, these export earnings depend on the availability of efficient air freight services.

17.4 Crocodile skins

In the last year alone, Air Niugini carried [CONFIDENTIAL INFORMATION DELETED]kgs of Crocodile skins being exported to Singapore, Hong Kong and Japan.

18. IMPROVEMENTS TO SERVICES

The codeshare arrangements with Qantas allow better services to be provided to Papua New Guinean consumers in a range of ways

(a) [CONFIDENTIAL INFORMATION DELETED]

(b) Jet services to Cairns. Under the Current Codeshare Agreement, Air Niugini has been able for the first time to provide a high frequency jet service to Cairns. If the Renewed Codeshare Agreement is not authorised, some or all of these services will need to revert to smaller, propeller “Dash 8” aircraft, with a resultant loss of speed and comfort for travellers on this route.

¹⁶ National Fisheries Authority, Papua New Guinea "PNG Fisheries – Tuna", available at: http://www.fisheries.gov.pg/fisheries_tuna.htm

¹⁷ National Fisheries Authority, Papua New Guinea "PNG Fisheries – Prawn & Lobster", available at: http://www.fisheries.gov.pg/fisheries_prawn&lobster.htm

¹⁸ National Fisheries Authority, Papua New Guinea "PNG Fisheries – Barramundi", available at: http://www.fisheries.gov.pg/fisheries_barramundi.htm

- (c) Comfort and security of widebody services to Brisbane. In addition to allowing the carriage of freight, the larger size of a widebody aircraft provides a smoother ride and, for many passengers, a greater sense of security and wellbeing than travelling on narrowbody aircraft. If the Renewed Codeshare Agreement is not authorised, this greater comfort and sense of security currently provided by the use of widebody aircraft will be lost.

19. EFFICIENCIES

For reasons outlined above, the effect of loss of Air Niugini's codeshare arrangements with Qantas would ultimately be the replacement of the current Air Niugini widebody services with duplicated narrowbody services between Australia and Papua New Guinea.

A widebody aircraft provides lower per passenger costs and results in lower per passenger greenhouse gas emissions than carrying the same number of passengers on duplicate narrowbody services. Accordingly, failure to authorise the Renewed Codeshare Agreement would be likely to result in a significant increase in per passenger costs and per passenger greenhouse gas emissions compared with the likely outcome if the Renewed Codeshare Agreement is authorised.

20. DIRECT SERVICES TO AUSTRALIA FROM REGIONAL AIRPORTS

Air Niugini has recently announced that it will trial a series of scheduled services each month between Rabaul and Cairns from April until 2007 using its F100 aircraft. These initial trial services are being partially underwritten by the East New Britain Provincial Government. Air Niugini anticipates that an approach will also be made shortly by the Milne Bay Provincial Government for Air Niugini to trail similar services between Gurney and Cairns.

Such services, if sustainable on a long term basis, will clearly offer substantial benefits to residents of these regions, allowing them to travel directly to Australia, rather than via Port Moresby, with consequent cost savings and improvements in travel time and convenience.

If, after initial trial periods, Air Niugini believes these services can be made sustainable, it will seek to commence permanent services on these routes, and explore the possibility of other new services on similar routes. The prospects of permanent services on these routes will be substantially enhanced if the Renewed Codeshare Agreement is authorised and Qantas is able to codeshare on the services and has an incentive to bring its considerable Australian marketing resources to bear to support the services.

21. EMPLOYMENT BENEFITS

21.1 Likely short term effects of loss of codeshare

The short term effect of loss of termination of Air Niugini's codeshare arrangements with Qantas is that Air Niugini would be forced to at least halve the number of widebody services it operates between Australia and Papua New Guinea. The result would be a substantial reduction in the number of pilots and crew required to operate the aircraft, with a consequent loss of jobs.

Flow on job losses would also be likely to a result from the reduction in requirements for a range of support services such as catering, engineering and maintenance and cleaning services.

It is also possible that Qantas may terminate its ground handling agreement with Air Niugini in Port Moresby. This would be likely to lead to further job losses.

21.2 Likely longer term effects of loss of codeshare

If Air Niugini is forced to withdraw from widebody aircraft operations, it is likely that as many as 50 jobs would be lost directly from the operation of this aircraft alone, as follows:

- 10-12 tech crew;
- 25-30 cabin crew;
- 10-12 catering staff; and
- a number of other support staff.

In addition, since Air Niugini would be forced with loss of the codeshare to become a smaller, less significant airline, larger scale restructuring and job losses would be required. Air Niugini estimates that, ultimately, it would be forced to bring its workforce close to 900 employees from its current level of 1350.

22. NATIONAL FLAG AIR CARRIER

For reasons described throughout this submission, the support provided to Air Niugini's widebody operations by its codeshare arrangements with Qantas underpin the strength of Air Niugini as the nation's national carrier in a range of ways.

Having a flag air carrier with the strength and service capability of Air Niugini provides important benefits to the people of Papua New Guinea. For example, having a strong national air carrier is important from a security and safety perspective. In times of national crisis or emergency, a national carrier is a valuable resource. For example, after the Bali bombing on 12 October 2002, many injured Australians required evacuation to Darwin, and then to burns units around Australia. In response, Qantas was able to transport approximately 1,700 people from Bali to Sydney on six special flights from Bali to Australia, as well as transport medical staff and supplies to Bali. Similarly, in the wake of

the earthquake and series of tsunamis that devastated South East Asia in 2004, Qantas operated a special flights to Phuket, The Maldives and Colombo in Sri Lanka to bring travellers home to Australia. When the Ansett Australia Group collapsed in 2001, Qantas leased extra aircraft and withdrew aircraft from a number of services (including its Papua New Guinea service) in order to add hundreds of special domestic flights to assist stranded Ansett passengers.

The maintenance of Air Niugini as a strong national airline means that similar resources are available to the people of Papua New Guinea should they ever be required.

ANNEXURE A - AUSTRALIAN SERVICES AND HARD AND SOFT BLOCK ALLOCATIONS UNDER CURRENT CODESHARE AGREEMENT

Codeshare Services

| Service | Weekly Frequencies (return trips) | Aircraft |
|-------------------|--|-----------------|
| Cairns Route | 18 (9 x RT) | Fokker. F-100 |
| Brisbane Route | 12 (6 x RT) | Boeing B-767 |
| | 2 (1 x RT) | Fokker F-100 |
| Sydney Route | 4 (2 x RT) | Boeing B-767 |

Qantas Hard Block and Soft Block allocations

[CONFIDENTIAL INFORMATION DELETED]

**ANNEXURE B - PROPOSED CODESHARE SERVICES UNDER RENEWED
CODESHARE AGREEMENT**

If authorisation is granted, the Renewed Codeshare Agreement is likely to include the following codeshare services:

- (a) POM/BNE B767-300ER Tue, Thu, Fri x2, Sun x2 (as per current)
- (b) BNE/POM B767-300ER Mon, Tue, Thu, Fri, Sat, Sun (as per current)
- (c) [CONFIDENTIAL INFORMATION DELETED]
- (d) [CONFIDENTIAL INFORMATION DELETED]
- (e) POM/CNS/POM No change from current schedules.
- (f) [CONFIDENTIAL INFORMATION DELETED]
- (g) [CONFIDENTIAL INFORMATION DELETED]

It is anticipated that current hardblock on B767 will remain similar to current and likewise for Cairns services.

**ANNEXURE C – PROJECTIONS OF SERVICE PROFITABILITY WITH AND WITHOUT
THE RENEWED CODESHARE AGREEMENT**

[CONFIDENTIAL INFORMATION DELETED]

ANNEXURE D – HISTORIC CODESHARE ROUTE PROFITABILITY

[CONFIDENTIAL INFORMATION DELETED]

ANNEXURE E - AIR NIUGINI SUBMISSIONS ON MARKET DEFINITION

1. BACKGROUND

Section 45(2) of the ICCC Act defines a "market" as follows

“...a reference to a market in the whole of Papua New Guinea for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them, including imports”.

The ICCC has in the past defined relevant markets in terms of the following characteristics or dimensions:

- (a) the goods or services supplied and purchased (the **product dimension**);
- (b) the level in the production or distribution chain (the **functional level**); and
- (c) the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the **geographic dimension**).¹⁹

Air Niugini notes that the ICCC has not made any determinations relating to the Papua New Guinean air services industry. Furthermore, the ICCC Report did not seek to define relevant markets in the Papua New Guinean air services industry. Accordingly, for the purposes of defining the relevant markets which may be affected by the Renewed Codeshare Agreement, Air Niugini has sought guidance from previous determinations of the Australian Competition and Consumer Commission (**ACCC**), the Australian Competition Tribunal (**ACT**) and the Commerce Commission of NZ (**NZCC**).

2. MARKET DEFINITION - PASSENGER AIR SERVICES MARKETS

2.1 Product dimension

Air Niugini submits that there is one product market for air passenger services, with no separate markets for business customers and leisure customers, or for different cabin classes (business and economy).

This is consistent with the approach taken by both the NZCC in its determination in relation to the proposed alliance between Qantas and Air NZ in 2003, and by the Australian Competition Tribunal in considering the same alliance.^{20 21}

¹⁹ See for instance the ICCC's determination on the acquisition of Shell by IPL in 2005, and the ICCC's determination on the acquisition of Nebiri Quarries and Monier in 2004.

²⁰ *Re Qantas Airways Ltd* [2004] A CompT 9, at [241]

Air Niugini submits that, in any case, it is unlikely to make any material difference to the analysis presented in this application whether the relevant market is defined as a single product market for air passenger services, or separate product markets for business and leisure air passenger services.

2.2 Functional level of the market

The ACCC and the NZ Commission have in past determinations made no distinction between functional levels of the air services market.²² For example, in Determination A90649 / 90655 and Determination A30202, the ACCC defined a single market for ticket sales, with no separate functional levels. In Determination A90649 / 90655, the ACCC noted that consumers could purchase tickets from any segment of the distribution system, including from travel retailers, travel wholesalers and directly from airlines. This was also the view formed by the ACCC in Determination A30202, where it noted that consumers viewed airlines as an alternative source of tickets to travel agents.

This application therefore proceeds on the basis that it is not necessary to define or analyse separate functional levels within the air passenger services market.

2.3 Geographic dimension

In accordance with the approach adopted by IATA²³, the ACCC and the NZCC,²⁴ Air Niugini submits that relevant geographic markets for international air passenger services are country-to-country between:

- (a) Papua New Guinea and Australia (the **Australian Passenger Air Services Market**); and

²¹ Air Niugini notes that, with respect to the product dimension of the definition of air passenger transport markets, the ACCC has suggested that there may, in some cases, be a separate markets for economy and business class passengers (See ACCC's Determination No A30226-7 in relation to the Joint Services Agreement between Qantas and British Airways. See also ACCC's Determinations A30220-3 and A90862-3 in relation to the Qantas and Air NZ applications for authorisation.) Air Niugini notes, however, that the ACCC view was reached in the consideration of extreme long haul travel of over 20 hours' duration. The ACCC indicated that its findings in relation to long haul travel routes should not be taken to imply that there are also separate markets for business and leisure travellers on shorter routes, such as the routes the subject of this application. It is important to note that the ACCC's determination was overturned by the Australian Competition Tribunal. The Tribunal rejected the notion that there were separate markets for business and leisure travellers.

²² Note that the NZ Commission expressed in its Determination on the proposed alliance between Qantas and Air NZ that the functional dimension is not relevant to the analysis of air passenger markets.

²³ See IATA Annotated ACCC Discussion Paper, at [7.18]: "There is no justification for treating a point to point route as a market. This is contrary to the approach taken by the Full Federal Court in *Singapore Airlines* and to the approach taken by the Tribunal in *Re Qantas*" (reference to *Re Qantas Airways Ltd* [2004] A CompT 9).

²⁴ See NZ Commerce Commission final determination on the proposed alliance between Air NZ and Qantas.

- (b) Papua New Guinea and each of the other international destinations currently serviced by Air Niugini B767 aircraft (together, the **Asian Passenger Air Services Markets**)

3. FREIGHT MARKETS

3.1 Product dimension

Air Niugini submits that there is a single product market for air freight services.

3.2 Functional level

Air Niugini notes that the majority of air freight to and from Papua New Guinea is sold through freight forwarders. Unlike air passenger services, these companies sell some air freight services as agent for the relevant carrier, and other services as principal. This makes the analysis of whether or not different functional markets exist within the market for air freight services complex.

For the purposes of this application, Air Niugini has analysed the market for air freight services as a single functional market. Air Niugini considers, however, that the results of this analysis would be identical if the market were analysed as having different wholesale and retail functional levels.

3.3 Geographic market

All air freight to and from Papua New Guinea is currently carried in the belly-holds of passenger aircraft. This suggests that the geographic dimension of each air freight market is likely to be at least as broad as the corresponding passenger air services market.

In addition, Air Niugini notes that the precise routing by which most cargo is air freighted to its destination is not especially important - provided the freight arrives on time and in good condition indirect routings will be substitutable with direct routings. This too suggests that the geographic dimension of air freight markets is likely to be at least as broad as for corresponding passenger air services market. Accordingly, Air Niugini believes the relevant geographic markets for international air freight services are country-to-country between:

- (a) Papua New Guinea and Australia (the **Australian Air Freight Market**); and
- (b) Papua New Guinea and each of the other international destinations currently serviced by Air Niugini B767 aircraft (together, the **Asian Air Freight Markets**)

ANNEXURE F – LOAD FACTORS BY ROUTE BY MONTH

[CONFIDENTIAL INFORMATION DELETED]

ANNEXURE G - ANALYSIS OF QANTAS AND AIR NIUGINI AIR FREIGHT SALES

[CONFIDENTIAL INFORMATION DELETED]

ANNEXURE H - AIRLINE BUSINESS' AIRLINE ALLIANCE SURVEY 2006