

CODE SHARE ARRANGEMENT

BETWEEN

**AIRLINES OF PAPUA NEW GUINEA LIMITED
PACIFIC BLUE AIRLINES (AUST) PTY LIMITED
VIRGIN BLUE AIRLINES PTY LIMITED**

**SUBMISSION IN SUPPORT OF APPLICATION FOR
AUTHORISATION UNDER SECTION 70 OF INDEPENDENT
COMPETITION AND CONSUMER COMMISSION ACT**

10 SEPTEMBER 2008

[PUBLIC RELEASE VERSION]

CONTENTS

1.	EXECUTIVE SUMMARY.....	1
1.1	Introduction	1
1.2	Current Market Structure	1
1.3	Competitive Structure of Proposed New Code Share between Airlines PNG and Pacific Blue	1
1.4	Public Benefits of New Code Share	2
1.5	Conclusion	3
2.	THE APPLICATION	4
2.1	Application for Authorisation	4
2.2	Description of the Parties	4
2.3	Details of Code Share Arrangement	5
3.	RATIONALE FOR THE CODE SHARE ARRANGEMENT.....	7
3.1	Stemming Airlines PNG Losses on the Route	7
3.2	Strengthening Competitive Response to Qantas/ Air Niugini Joint Code Share Operations	7
3.3	Improved Services to Passengers on PNG/ Australia Routes	8
3.4	Port Moresby Brisbane Route not Viable for Pacific Blue on its own account	8
4.	COMPETITION AND MARKET ANALYSIS.....	10
4.1	Market Definition	10
4.2	Present Market Structure	11
4.3	Effect on the Market	11
5.	PUBLIC BENEFITS.....	13
5.1	Summary of Benefits	13
5.2	Stonger Competitive Response to the Qantas/ Air Niugini Code Share	13
5.3	New More Efficient Operating Aircraft / Lower Seat Cost of Operations	14
5.4	Reduced CO2 Emissions	14
5.5	Increased Services	15
5.6	Improved Travel Services for Business and Tourism	15
5.7	Additional Training and Development Opportunities	16
5.8	Contribution to Government Revenues	17
6.	FUTURE MARKET CONDUCT	18
6.1	Likely Outcome if Authorisation is Granted	18
6.2	Likely Outcome if Authorisation is Refused	18
7.	CONCLUSION AND RECOMMENDATION	20

1. EXECUTIVE SUMMARY

1.1 Introduction

Airlines of Papua New Guinea Limited (**Airlines PNG**) and Pacific Blue Airlines (Aust) Pty Limited (ACN 097 892 389) (**Pacific Blue**) have reached agreement to code share as marketing carriers on the Port Moresby/Brisbane air transport route. The parties will use a Boeing 737-800 aircraft on the route which Pacific Blue will lease from Virgin Blue Airlines Pty Limited (ACN 090 670 965) (**Virgin**).

The code share will be for a term of three years and each of Airlines PNG and Pacific Blue will take hard blocks of space on the aircraft and compete with each other as marketing carriers and also compete with Qantas and Air Niugini as joint operators of their code share service.

Airlines PNG on behalf of all parties to the code share arrangement makes application for authorisation under section 70 of the *Independent Consumer and Competition Commission Act 2002 (ICCC Act)*.

1.2 Current Market Structure

The current market structure for air services between Papua New Guinea and Australia (**the Australian Routes**) provides a range of carriers, equipment types and timetable options.

The dominant operators on the Australian Routes are Qantas and Air Niugini who have combined their services jointly on three routes operated pursuant to a Code Share Agreement which has received approval from the ICCC until the end of 2009. Air Niugini operate the main services between Port Moresby and Brisbane using a Boeing 767 wide body jet (supplemented by several B757 and E190 services) and a number of the Port Moresby/Cairns services using Air Niugini's Fokker F100 aircraft. Air Niugini wet leases an Embraer E145 aircraft from Sky Air World to operate some of the Cairns services and services between Port Moresby and Sydney. Qantas participates on all of these routes as a marketing carrier only.

Both carriers are subject to competition from Airlines PNG which operates daily flights on the Port Moresby/Cairns route using a Dash 8 turbo prop aircraft and three days per week on the Port Moresby/Brisbane Route using a wet leased Boeing 737-300.

1.3 Competitive Structure of Proposed New Code Share between Airlines PNG and Pacific Blue

Pacific Blue has proposed to enter the Route as marketing carrier operating a jet wet leased from its related corporation Virgin. Pacific Blue has applied for capacity from the Australian International Air Services Commission for initially four services per week potentially increasing to five services per week using a 180 seat Boeing 737-800 Jet. Pacific Blue will stage the flights between Port Moresby and Brisbane.

Airlines PNG presently operates 3 services each week between Brisbane and Port Moresby providing 390 seats in each direction. Pacific Blue and Airlines PNG propose a code share pursuant to which Airlines PNG will be allocated a hard block of [deleted] seats on the services and Pacific Blue will retain [deleted] seats. Together, Pacific Blue and Airlines PNG will compete with each other for the sale of their respective hard blocks of seats and with Qantas and Air Niugini each of whom respectively are said to compete on their joint services with their hard blocks.

In effect, on the largest route, being the Port Moresby/Brisbane Route, there will be two operating carriers and four marketing carriers. Airlines PNG will maintain its own services to Cairns in competition with the services direct to Brisbane and Sydney and the hard block competition between Qantas and Air Niugini in respect to their various Port Moresby/Cairns and Port Moresby/Sydney code share services.

1.4 Public Benefits of New Code Share

There will be significant public benefit under the new code share. These benefits include:

- (a) The strengthening of Airlines PNG's competitive response to the Qantas/Air Niugini joint code share operations by providing Airlines PNG with more frequent services, access to near new current model Boeing 737-800 next generation jets and the ability to interline passengers respectively through each of Airlines PNG and Virgin domestic routes.
- (b) There will be improved services to passengers due to the introduction of the current model Boeing 737-800 jets. Passengers will benefit from the reduced operating costs which are derived from the well documented lower seat mile cost of the Boeing 737-800 compared to earlier models such as the Boeing 737-300. Passengers will also travel in a quieter and better equipped cabin with personal in-flight entertainment systems. More points of difference will emerge in the marketing of the respective services between the carriers, bearing in mind Virgin's no-frills low cost carrier model compared to the traditional full service model adopted by Qantas and Air Niugini on their routes.
- (c) There will be increased frequencies and additional seat capacity available which should increase travel opportunities for passengers and lead to decreased costs due to simple supply and demand equations.
- (d) The late model 737-800 jets are documented to produce lower amounts of carbon dioxide emission into the environment and the public will benefit from the reduced CO² outputs arising from their travel.
- (e) The increased opportunities for interlining and the increased capacity will add stimulus to business and tourism in Papua New Guinea. Pacific Blue is intended by Virgin as leisure carrier because holiday makers and people visiting friends are its target customers.

1.5 Conclusion

Airlines PNG contends that there are no anti-competitive effects and that the code share arrangement proposed increases competition in a sustainable manner.

The public benefits of the code share arrangement far exceed any of the detrimental or anti-competitive effects of the code share arrangement.

The code share arrangement provides a means by which Airlines PNG, presently a weaker competitor to Qantas and Air Niugini, can strengthen its competitive performance and with Pacific Blue to provide competition on an equal footing with Qantas.

For the same reasons as the Commission has already approved the Qantas and Air Niugini Code Share Agreement, there is no risk of anti-competitive conduct emerging between Airlines PNG and Pacific Blue as each will be locked in competition with each other to market the hard blocks each is committed to and there is a significant increase in capacity on the route.

The logic applied by the Commission in approving the existing Code Share Agreement between Qantas and Air Niugini holds true for the proposed code share between Airlines PNG and Pacific Blue, with the added advantage that the introduction of the second code share and the fourth marketing carrier reinstates any loss of competition in the market which might have arisen from the Commission's prior approval of the Air Niugini and Qantas code share.

The benefits to the nation will be substantial.

2. THE APPLICATION

2.1 Application for Authorisation

Airlines PNG makes this submission in support of its application for authorisation pursuant to section 70 of the *Independent Consumer and Competition Commission Act 2002 (ICCC Act)* to enter into and give effect to a code share arrangement with Pacific Blue as Marketing Carrier and Virgin as Operating Carrier.

It is intended that this submission made by Airlines PNG should have effect on behalf of and bind each of Pacific Blue and Virgin as parties to the proposed code share arrangement in accordance with Section 72(1) of the *ICCC Act*.

The conduct for which authorisation is sought is the entering into and giving effect to by performance of, a code share agreement between Airlines PNG and Pacific Blue as Marketing Carriers with Virgin Blue as Operating Carrier notwithstanding the natural effect of provisions of the code share agreement might otherwise be offensive to the provisions of Part VI Division 2 of the *ICCC Act*.

2.2 Description of the Parties

(a) *Airlines PNG*

Airlines PNG is a company incorporated in Papua New Guinea. It is the successor to a group of companies which had been operating as MBA or Milne Bay Air. That business was started in 1987 with one aircraft operating from Mawenuana Plantation on China Straits. In the ensuing 21 years, its founder, John Wild, built the business into a significant airline in the Australasian region. During 2008, at the age of 79, John Wild floated the company on the Port Moresby Stock Exchange in an initial public offering. The Wild family maintain a significant holding in the company which now has over 2,300 shareholders.

Airlines PNG has over 500 employees, carries in the order of 225,000 passengers each year and operates a fleet of 18 aircraft. It is Papua New Guinea's second largest airline. For the financial year ended 31 December 2007, Airlines PNG revenue was K133 million.

Airlines PNG's main business is the transportation of passengers and freight within Papua New Guinea and internationally to Australia. Prior to 2005, Airlines PNG only operated regular passenger services and charter services domestically in Papua New Guinea and internationally to Australia on charter services for specific customers.

In 2005, Airlines PNG commenced regular passenger transport services between Port Moresby and Cairns and 2006 it started regular passenger transport services between Port Moresby and Brisbane.

Airlines PNG's main fleet work horses are the 36 seat Dash 8 and the 19 seat Twin Otter which are both turbo-prop aircraft designed for short takeoff and landing in mountainous terrain. Airlines PNG owns its entire Dash 8 and Twin Otter fleet with the exception of one aircraft which it leases. For the Brisbane services, Airlines PNG has been wet leasing a Boeing 737-300 three days of each week from the Nauru Air Corporation trading as Our Airline.

(b) *Pacific Blue and Virgin*

Pacific Blue and Virgin should be viewed collectively part of a group of companies under the ownership and control of Virgin Blue Holdings Limited which is listed on the Australian Stock Exchange. Virgin Blue Holdings Limited is partly owned by Sir Richard Branson and the use of the "Virgin" brand has been licensed for use only within Australia. For all services outside Australia, Virgin Blue Holdings Limited utilises alternative branding such as Pacific Blue, Polynesian Blue and more recently the soon to be launched V Australia.

Within Australia, Virgin Blue is Australia's second largest airline, in direct competition to the Qantas group which includes Qantas, Jetstar and Qantas Link. Virgin Blue launched itself as a domestic low cost carrier before establishing trans-Tasman services and is in the process of establishing V Australia as a full service international airline connecting Australia with the United States of America, Africa and additional destinations yet to be announced.

Virgin and Pacific Blue have no present representation in Papua New Guinea.

Pacific Blue has recently applied for capacity as an Australian carrier from the Australian International Air Services Commission to operate four Boeing 737-800 services per week to Papua New Guinea.

2.3 Details of Code Share Arrangement

The code share arrangement provides for Virgin to wet lease its aircraft to Pacific Blue for the conduct of the flights between Brisbane and Port Moresby.

On each flight, Pacific Blue will allocate a hard block of [deleted] seats to Airlines PNG and will retain for itself a hard block of [deleted] seats.

Airlines PNG and Pacific Blue will then compete with each other to sell the seats at a price above what the parties have determined is Virgin's per seat cost of operating. If Airlines PNG or Pacific Blue do not sell their respective hard blocks, any surplus of unsold seats are a loss with the respective code share marketing carrier having to pay the cost of providing the unused seat on the operating aircraft.

The arrangements also provide for Airlines PNG frequent flyers to be able to participate in the Virgin Velocity frequent flyer program. Subject to the conditions of membership of the scheme, this means Papua New Guineans will be able to 'earn' and 'burn' loyalty points on both Airlines PNG and Virgin sides of the code share

services (and on Velocity partner airlines). There are a number of airline partners in the Velocity program including Emirates, Malaysian and United Airlines.

The parties have also agreed that as soon as information technology systems permit, each carrier will interline over each others recognised connecting routes. This means that Airlines PNG will be able to sell seats from destinations in Papua New Guinea direct to ports in Australia beyond Brisbane. Likewise, Virgin will be able to sell tickets from Australian destinations to ports in Papua New Guinea beyond Port Moresby.

The date of 3 November 2008 is set as the commencement date for the code share services although the arrangement is conditional upon ICCC approval.

The cost of the seat provided to Airlines PNG is adjustable monthly to take into account movement in fuel prices and currency exchange rates and is to be renegotiated annually during the term of the code share arrangement.

The code share arrangement has a term of three years.

3. RATIONALE FOR THE CODE SHARE ARRANGEMENT

The code share arrangement has arisen as a result of Airlines PNG's necessity to:

- * lower its costs of operation on the Port Moresby/Brisbane route;
- * increase frequency;
- * rapidly stem the continuing losses Airlines PNG has sustained since 2006 on the route; and
- * better compete with Qantas and Air Niugini for through traffic.

From Pacific Blue and Virgin's side, Virgin now has surplus capacity in Australia due to economic contraction and increased fuel costs. Virgin seeks to redeploy aircraft outside Australia.

The parties have recognised that by bringing their different needs together, the proposed code share arrangement will allow sustainable operations which strengthen Airlines PNG's existing competitive response to the Qantas/Air Niugini operated services. Airlines PNG will have the opportunity to ensure its services remain sustainable by bringing them to profitability.

3.1 Stemming Airlines PNG Losses on the Route

Airlines PNG has sustained cumulative losses of approximately PGK[xx] million operating on the Brisbane route during the period from inception in 2006 until 30 June 2008. Budgets and financial models prepared by the airline earlier this year showed the services moving beyond break even into profitability during 2008. However, the very high oil costs encountered since April 2008 have set the profitability back and the service remains unprofitable for Airlines PNG.

For practical purposes, in Airlines PNG's view, the proposed code share arrangement is functionally equivalent to a fractional wet lease of a very fuel efficient aircraft and a means for Airlines PNG to increase frequency. Both these features are expected to make the route profitable for Airlines PNG.

3.2 Strengthening Competitive Response to Qantas/Air Niugini Joint Code Share Operations

Airlines PNG has found that it has not been able to compete effectively with Qantas and Air Niugini on the route due to Airlines PNG lack of frequency, lack of connecting destinations beyond Brisbane and lack of a frequent flyer program.

Overlaid over these features, Airlines PNG has found that, particularly Qantas, buys market share for itself on the Port Moresby Brisbane sector by combining very competitive interconnecting fares to other destinations which are not available to members of the public seeking to combine those sectors with travel on Airlines PNG on the Port Moresby Brisbane sector.

Airlines PNG has also found that due to its lack of frequency, passengers cannot combine a sector of Airlines PNG on the days Airlines PNG flies and on Air Niugini or Qantas on the days Airlines PNG does not fly because both Qantas and Air Niugini offer one way fares at approximately three-quarters to four-fifth of the price of a return ticket. This means that unless Airlines PNG is flying both days the passenger needs to travel, the passenger is effectively trapped into travelling with Air Niugini or Qantas. Whilst Air Niugini has recently launched a one way fare on the Brisbane Port Moresby route, the allocation of seats to this fare class is very limited and makes the fare mostly illusory to the travelling public.

The interlining arrangements included with the code share arrangement will assist Airlines PNG and Pacific Blue to provide customers with effective options for travel to destinations beyond Port Moresby or Brisbane on either end. Both Airlines PNG and Pacific Blue believe that this together with increased frequency to four flights per week will assist in building market share, better yields and sustainable operations on the Port Moresby Brisbane route.

3.3 Improved Services to Passengers on PNG/Australia Routes

There will be improved services for passengers. The improvement to inter-connection options is an example of this.

Other improvements include the greater frequency of services, the consistency of timetable and the high level of reliability and on time performance achieved by Virgin in its operations.

Latest model, near new aircraft which are quieter and produce less CO² emissions will provide passengers with improved comfort and reduce each passenger's carbon footprint.

Pacific Blue's operating model as a 'no frills' low cost carrier will give customers greater choice in choosing a service suitable for their needs.

3.4 Port Moresby Brisbane Route not Viable for Pacific Blue on its own account

Pacific Blue is a leisure carrier which targets its services to holiday makers and people visiting friends and relatives. Presently Papua New Guinea does not have a tourism industry of sufficient size to sustain a leisure carrier on the route.

Due to the absence of a defined tourism market in Papua New Guinea, Pacific Blue are only prepared to commit to [deleted] seats on the service between Brisbane and Port Moresby. By combining with Airlines PNG's passenger loads, this risk sharing will allow viable operation of the 180 seat jet.

As is explained in section 6.2, there is no likelihood that Pacific Blue would go it alone on the route due to the shortage of leisure passengers and the additional overhead costs of staging their own ground handling, line engineering and parts and consumables warehousing.

The arrangement represented in the code share arrangements provides a means by which Pacific Blue can add Port Moresby as a destination to its network in a sustainable manner.

4. COMPETITION AND MARKET ANALYSIS

4.1 Market Definition

Section 45(2) of the ICCA Act defines a market as:

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

In previous submissions made to the Commission during 2007 in respect to the Air Niugini Qantas code share authorisation application, Air Niugini advanced arguments that there were three segments to the market which are the Australian Passenger Market, the Australian Freight Market and the Asian Freight Market.

The Commission accepted¹ that there was a distinction in the market between passenger markets and freight markets and a further distinction between the Australia PNG market for both and the Asia PNG market for both.²

Airlines PNG accepts this analysis and like the Commission decided in the Air Niugini application³ contends that only the Australia PNG market is relevant to the present code share agreement.

In terms of the Australia PNG market, Airlines PNG contends that only the Passenger Market sub-set is relevant to this application because the service is to be operated by a Boeing 737-800 narrow body aircraft. The Boeing 737-800 is capable of carrying only a very limited amount of small parcel cargo and the aircraft does not take containerised cargo like wide body aircraft such as the Boeing 767 operated by Air Niugini. The same situation applies in respect to Airlines PNG present B737-300 model operating aircraft on the Brisbane Port Moresby route.

Airlines PNG also accepts and contends that in terms of the Australia PNG regular passenger transport market, that the market is to be taken as a whole and that no further distinction is required between distinct routes between the two countries. Between the two countries, there are three distinctive routes being:

- (a) Port Moresby – Cairns;
- (b) Port Moresby – Brisbane; and
- (c) Port Moresby – Sydney.

¹ See Final Determination of the Independent Consumer and Competition Commission on an application by Air Niugini Limited for Authorisation for its Code Share Application with Air Niugini dated 16 November 2007.

² Ibid.

³ Ibid.

4.2 Present Market Structure

The present structure of the regular passenger transport market between Australia and Papua New Guinea is shown in the table below:

Route	Operating Carrier	No of Return Services per week	Seats Available each way per week	Marketing Carrier(s)
POM/ CNS	Airlines PNG	8 x DHC-8 services [confidential information deleted]	288 seats [confidential information deleted]	Airlines PNG
	Air Niugini (including wet lease from Sky Air World)	3 x F100 services 11 x EMB145 services	294 seats 528 seats	Air Niugini & Qantas
POM/ BNE	Airlines PNG (wet lease from Nauru Air Corporation)	3 x B737-300 services	390 seats	Airlines PNG
	Air Niugini (including wet leases from Sky Air World and Icelandic Air)	5 x B767 services 2 x B757 services (*1 service commences/ends SYD) 2 x EMB190 service	1020 seats 378* seats 196 seats	Air Niugini & Qantas
POM/ SYD	Air Niugini (wet lease from Icelandic Air)	2 x B757 services (1 via BNE)	378 seats	Air Niugini & Qantas

4.3 Effect on the Market

The proposed code share arrangement will have the following effect on the market:

- (a) The frequency of services between Brisbane and Port Moresby will increase by one additional flight per week;
- (b) Airlines PNG (wet leasing from Nauru Air Corporation) will withdraw as operating carrier and will be replaced by Pacific Blue (wet leasing from Virgin) as operating carrier;
- (c) Airlines PNG will become a marketing carrier only, having the majority hard block on the code share services;
- (d) The Boeing 737-300 operating aircraft will be replaced by a Boeing 737-800;
- (e) The increased seating capacity of the Boeing 737-800 and the increased frequency means that seat availability increases from the original Airlines

PNG availability of 390 seats in each direction per week to 720 seats in each direction per week.

By redrawing the table set out in section 4.1 above, the limited effect of the Airlines PNG code share with Pacific Blue in the market is clearly seen:

Route	Operating Carrier	No of Return Services per week	Seats available each way per week	Marketing Carrier(s)
POM/ CNS	Airlines PNG	8 x DHC-8 services [confidential information deleted]	288 seats [confidential information deleted]	Airlines PNG
	Air Niugini (including wet lease from Sky Air World)	3 x F100 services 11 x EMB145 services	294 seats 528 seats	Air Niugini & Qantas
POM/ BNE	Pacific Blue (wet lease from Virgin Blue)	4 x B737-800 services	720 seats	Airlines PNG & Pacific Blue
	Air Niugini (including wet leases from Sky Air World and Icelandic Air)	5 x B767 services 2 x B757 services (*1 service commences/ends SYD) 2 x EMB190 service	1020 seats 378* seats 196 seats	Air Niugini & Qantas
POM/ SYD	Air Niugini (wet lease from Icelandic Air)	2 x B757 services (1 via BNE)	378 seats	Air Niugini & Qantas

5. PUBLIC BENEFITS

5.1 Summary of Benefits

A significant number of public benefits arise from the proposed code share arrangement between Airlines PNG and Pacific Blue. In summary, these include:

- (a) Stronger competitive response to Qantas/ Air Niugini joint operated services pursuant to their codeshare arrangement;
- (b) More efficient lower cost operations due to Virgin's large fleet of efficient B737-800 model jets;
- (c) Reduced fuel consumption and reduced carbon dioxide emissions which make the operations more environmentally sustainable;
- (d) Increased number of services and increased seat capacity providing a more competitive environment;
- (e) More reliable on time operations;
- (f) Increased allocative efficiency in the PNG aviation market by relieving Airlines PNG of loss making Brisbane services;
- (g) Training and development opportunities through requirement for new skills; and
- (h) Increased opportunity for the Independent State of Papua New Guinea to collect goods and services taxes and increased airport tax revenue.

5.2 Stronger Competitive Response to the Qantas/Air Niugini Code Share

As outlined in section 3 above, both Qantas (due to its more expansive route structure) and Air Niugini and Qantas (due to their greater route frequency) have been able to provide passengers with choices which Airlines PNG has not been able to effectively match.

With additional frequency under the proposed new arrangement, and by Airlines PNG being able to add Australian domestic destinations and Pacific Blue being able to add Papua New Guinea domestic destinations through the interline aspects, a more effective competitive response to Qantas and Air Niugini emerges.

This is beneficial to the public because it has effect to significantly neutralise any anti-competitive features which exist under the existing Qantas Air Niugini Code Share Agreement.

5.3 New More Efficient Operating Aircraft / Lower Seat Cost of Operations

The risk sharing inherent in the code share arrangements proposed by Pacific Blue and Airlines PNG allow the very latest high efficiency Boeing 737-800 to be brought onto the Port Moresby Brisbane route for the first time.

These aircraft carry 180 passengers and whilst having a high capital cost, deliver a much lower seat/mile cost than older aircraft such as the B737-300 or the Boeing 767-300 aircraft.

Virgin Blue also has 53 Boeing 737-800 jets over which to spread its fixed costs. This means that for each seat it sells, the cost component representing fixed overhead costs is much lower than an operator of a much smaller fleet or a single aircraft would be able to achieve.

The arrangements Airlines PNG and Pacific Blue have been able to negotiate allow Airlines PNG the benefit of these cost efficiencies. The hard block arrangement allows Airlines PNG to sell its seats at a margin over this predetermined cost of operations and passengers will benefit through the lower costs. Airlines PNG also believes that it will be able to make its Brisbane services viable under this arrangement and stop the process of having to cross-subsidise the Brisbane service from its other more profitable routes.

5.4 Reduced CO2 Emissions

A direct tangible effect of the code share is the retirement of the Airlines PNG wet leased B737-300 aircraft from service and its replacement with the 800 series model. This retiring aircraft is over 20 years old and has old technology engines and does not have the benefits of the aerodynamic improvements, engine combustion technology and material strength to weight improvements found on the B737-800.

With a price tag of approximately USD53.0m, ownership of a B737-800 is outside the financial capacity of any PNG operator, so without the arrangement with Pacific Blue and Virgin for the use of the aircraft, Airlines PNG would not have access to such an efficient aircraft and it would not be able to market seats on the aircraft.

ICAO analysis of aircraft performance types show that for each landing and takeoff cycle there is approximately a 20% reduction in fuel and carbon dioxide emissions per passenger produced by the B737-800 aircraft compared to the B737-300 aircraft. During cruise, fuel burn efficiency of the B737-800 over the B737-300 is approximately a 25% improvement. This derives in part from the increase in capacity from 130 passengers to 180 passengers.

The details are shown in the table below⁴:

⁴ International Civil Aviation Organisation Information Paper CAEP/7-IP/10 dated 11 October 2006 prepared for the Seventh Meeting of the Committee of Aviation Environmental Protection held at Montreal 5 - 16 February 2007

Aircraft Type	No of Pax	CO ₂ KG/LTO/Pax	LTO Fuel Burn Kg/Pax	Cruise Fuel Burn Kg/Nm/Pax
B737-300	130	19.07	6.00	0.034
B737-800	180	15.44	4.88	0.027
B767-300	204	27.5	8.72	0.041

The significant advantage in reduced fuel consumption will provide public benefit by:

- (a) Reducing the underlying operating cost to Airlines PNG allowing more competitive fares and improved economic efficiency;
- (b) Reducing the amount of green house gas produced per passenger which will result in avoidance of the economic and environmental consequences of the carbon dioxide which would otherwise have been produced by the 737-300;
- (c) Allowing travelers a choice of being environmentally responsible; and
- (d) Conserving petroleum for use in the future when it is likely to be more scarce.

If the Commission accepts that Airlines PNG could not on its own account acquire a Boeing 737-800 and that Pacific Blue would not place the aircraft in the market other than on the basis pursuant to the code share arrangement negotiated between the parties, then the public environmental benefits set out above would not be available.

5.5 Increased Services

The code share arrangement will see an immediate increase in flight frequency. The ceasing of the three Airlines PNG flights per week is replaced by four Pacific Blue code share flights. Utilising the larger 180 seat Boeing 737-800, an additional 330 seats are added to the route in each direction each week.

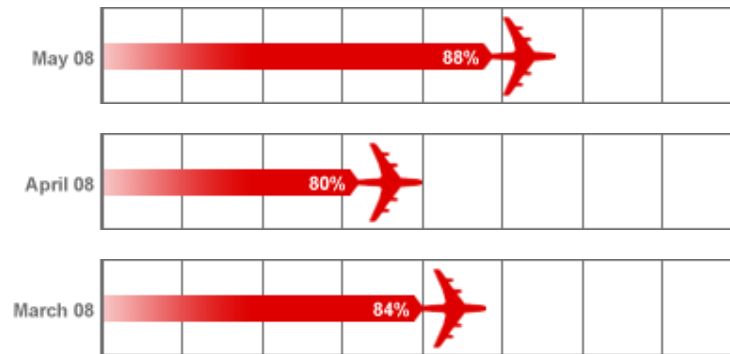
This provides the public with the benefit of an additional flying opportunities and the increase in seats will, by virtue of the economic principles of supply and demand, provide downward pressure on prices.

The addition of Pacific Blue as a fourth marketing carrier with the competitive pressure to sell its hard block of seats will provide more choice for travellers.

5.6 Improved Travel Services for Business and Tourism

The late model near new aircraft will be more reliable than the older operating equipment. Passengers will also have the benefit of Virgin's reliable on time operating efficiency.

A table showing Virgin's on time operations appears below:



The addition of reliable on time services will reduce the cost of delays and distress to business and tourism caused by stranded and disrupted passengers.

Pacific Blue's inclusion as a leisure carrier will boost tourism and that in turn will have multiplier effects on business growth generally. The provisions for interlining by both Pacific Blue and Airlines PNG over each others routes will enable passengers more integrated passenger services and greater reach for their respective route networks.

Reliability and increased route network deliver significant public benefits. These benefits have not been available with the prior Airlines PNG services and would not be available if the code share arrangement does not go ahead due to the likelihood that Pacific Blue would not start services in its own right.

5.7 Additional Training and Development Opportunities

Presently there are no Licensed Aircraft Maintenance Engineers in Papua New Guinea with current B737 certifications. For the existing Airlines PNG services utilising the Nauru Air Corporation wet leased aircraft, a licensed Australian engineer travels to Port Moresby with the aircraft on each flight.

Airlines PNG is the only entity in Papua New Guinea which holds an Australian CAR30 maintenance authority from the Civil Aviation Safety Authority of Australia entitling it to do maintenance work on Australian Registered Aircraft.

There will be additional training benefits in Papua New Guinea because Airlines PNG will ultimately need to provide B737 endorsed engineers on the ground to ensure that any urgent line maintenance work required to be performed whilst the Virgin operating aircraft is on the ground in Port Moresby is properly certified.

The training, skills and certifications necessary to do line maintenance work on the Boeing 737-800 Next Generation jet is an important upskilling event because these aircraft have electronic control systems with 'glass cockpits'. Presently no operator in Papua New Guinea operates or performs maintenance of any type on such modern or advanced aircraft.

5.8 Contribution to Government Revenues

The increased passenger numbers will increase the revenue earned by the PNG government and the Civil Aviation Authority in passenger taxes.

More travellers coming to Papua New Guinea will increase the amount of GST revenue earned by the Government from spending on hotels, meals and entertainment in Papua New Guinea by the additional visitors.

There will also be multiplier effects from additional economic growth.

Each of the foregoing items will ensure that further public funds are available for investment in public infrastructure and welfare.

6. FUTURE MARKET CONDUCT

6.1 Likely Outcome if Authorisation is Granted

If authorisation is granted, Airlines PNG believes that it will be able to move its Port Moresby Brisbane route operations to a state of profitability. This will ensure the continuity of these services and also assist in returning allocative efficiency within the Airlines PNG route structure to enable the airline to compete more effectively with Air Niugini on certain other domestic routes.

The granting of approval for the code share arrangement will also bring Pacific Blue, a specialist leisure carrier, to the Papua New Guinea market for the first time as a marketing carrier. This means that Papua New Guinea will have greater ability to market its international grade accommodation and tourist opportunities overseas. The interlining with Airlines PNG on PNG domestic routes will assist the PNG tourism industry extend its reach through the Pacific Blue network.

There will be an extra 330 seats or an 17% increase in airline capacity on the Brisbane Port Moresby route. This will, applying the normal rules of supply and demand, lead to some downward pressure on prices, directly benefiting consumers. Even so, with the new lower cost base the arrangement gives to Airlines PNG, Airlines PNG believes it will become profitable on the route.

Approval of the codeshare is unlikely to have any immediate or long term impact on either Air Niugini or Qantas, both of whom are likely to continue operations as normal under their existing arrangements. Indeed, with a strengthening of competition into two competitive groups each with two marketing carriers and one operating carrier, may well deliver the market stability Air Niugini needs to continue its reflecting exercise with its planned ambitious acquisition of the Boeing 787 Dreamliner in public-private partnership with Qantas.

The approval of the proposed new code share arrangement between Airlines PNG and Pacific Blue with Virgin as the operating carrier is pro-competitive.

6.2 Likely Outcome if Authorisation is Refused

If authorization is refused or proposed to be granted on conditions which are not acceptable to the parties, Airlines PNG will need to reassess whether it continues to provide the Brisbane services at a loss. The services are presently being cross-subsidised from other operations. This is detrimental to allocative efficiency within the aviation sector of the PNG economy.

Pacific Blue would be unlikely to pursue the Brisbane/Port Moresby route on its own because it would need to establish costly infrastructure in PNG to ground handle and provide line maintenance to the Pacific Blue services. This would be very costly for a 4 day per week service and make the services uneconomical for Pacific Blue. Under the proposed arrangement Airlines PNG will provide ground handling, line engineering to fix aircraft breakdowns in Port Moresby and warehouse the Boeing

737-800 aircraft consumables and certain spare parts in Port Moresby at nil cost to Pacific Blue. Additionally, Pacific Blue would not commit to the route development costs necessary to market 720 seats on its own account.

Without the cost and risk sharing inherent the proposed arrangement, it is likely that Airlines PNG would leave the route and as Pacific Blue would not go it alone, there would be a loss of one operating carrier. This would return the market to the prior duopoly of Qantas and Air Niugini operating as marketing carriers with one operating carrier on the route. This arrangement saw air fares reach unprecedented heights during the period 2002 to 2006.

It would also deny the public the benefit of the environmental and operating efficiency of the B737-800 Next Generation jets.

The outcome would be bad for the public who would have less choices and higher costs.

7. CONCLUSION AND RECOMMENDATION

The code share arrangement proposed by Airlines PNG and Pacific Blue will enhance competition rather than lead to a reduction in competition.

There are significant and multiple public benefits in the arrangement. Most notably the arrangement will ensure that Airlines PNG presently unsustainable operations on the Port Moresby Brisbane route are put on a sustainable footing. It will strengthen the competitive response to the Air Niugini Qantas code share arrangement already approved by the Commission.

There will also be benefits to the public through the increase in frequency, an increase in capacity and the introduction of a modern efficient aircraft type onto the route will reduce carbon dioxide emissions.

The benefits would not be had without the code share arrangement.

There are no negative or anti-competitive side effects to approval of the code share arrangement. The code share arrangement itself provides workable effective competition between Airlines PNG and Pacific Blue as they compete to sell their respective hard blocks. Both will remain subject to the competition of Qantas and Air Niugini. There are also three separate air routes between Australia and Papua New Guinea in the Australia PNG passenger, so external competitive pressures will remain on the parties within the market.

Airlines PNG recommends to and requests the Commission to grant authorisation for the proposed code share arrangement.