1. (a) **Name of Applicant:** Air Niugini Limited

(b) **Address in PNG for service of documents:**
4th Floor
Air Niugini Haus
Jacksons Parade
Jacksons Airport
Port Moresby

(c) **Brief description of business carried on by applicant:**
Air Niugini is the National Airline of PNG and undertakes regular scheduled passenger and freight transportation throughout PNG and to overseas destinations.

2. (a) **Brief Description of agreement or practice and, where already made, its date:**
Air Niugini has one code share agreement with Qantas Airways Limited for air services between PNG and Australia. This agreement covers Air Niugini services between Port Moresby and Brisbane/Sydney and was first made in 2002. It has been approved and reapproved by the ICCC since that time the current approval expires on 30 September 2015.

This application is to allow Air Niugini to continue to codeshare flights between Port Moresby and Brisbane/Sydney, Australia. This application is for authorization of a new code share agreement with Qantas to allow the parties to continue to operate wide-body services to Australia as well as narrow bodied aircraft whilst competing for sales against each other.

(b) **Names and addresses of other parties to the proposed agreement or practice:**
Qantas Airways Limited
Qantas Centre Building A
203 Coward St
Mascot 2020
Sydney
NSW
Australia

3. (a) **Grounds for grant of authorization:**
Please refer to the submission here provided by Air Niugini

4. If you require confidentiality for any material provided as part of the application please specify:

Air Niugini has supplied two copies. One is marked Confidential Version and has sections in Red font and headers in RED font clearly illustrating information provided which is considered commercially confidential. It would be appreciated that this information is not made available generally as it could commercially damage Air Niugini (Please refer to our covering letter). The second copy marked Non Confidential Version has these RED font areas deleted.

Dated this 27th day of April 2015.

_________________________
Applicant
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Executive Summary

Application for Authorisation

This submission is made by Air Niugini Limited (Air Niugini) in support of an application for authorization of a codeshare agreement (Renewed Codeshare Agreement) with Qantas Airways Limited (Qantas) on routes between Port Moresby and Brisbane (Brisbane Route), and Port Moresby and Sydney (Sydney Route), for a period of five years from 1 October 2015 to 30 September 2020.

The Renewed Codeshare Agreement will be in similar terms to the current codeshare agreement (Current Codeshare Agreement), which expires on 30 September 2015. In response to concerns previously raised by the ICCC, the Renewed Codeshare Agreement will again involve “hard block” seat allocations only, giving Qantas a strong incentive to aggressively market these seats in competition with Air Niugini.

Air Niugini considers that the Renewed Codeshare Agreement will enable Air Niugini and Qantas to continue to operate on the Brisbane Route and Sydney Route more efficiently and offer better services and lower fares than if they operated on these routes independently. Air Niugini’s codeshare agreement with Qantas has now been in place in excess of 13 years and has delivered higher quality, higher frequency wide and narrow body jet services between Papua New Guinea and Australia. At the same time, it has led to lower fares, with average yields generally declining on the Brisbane and Sydney Routes over the course of the code sharing arrangements between Qantas and Air Niugini with increased frequency of services and also direct nonstop services to Sydney since April 2008.

These additional nonstop direct services to Sydney will not be financially sustainable without the codeshare revenue.

Importantly for Papua New Guinea, the codeshare makes it possible for Air Niugini to operate wide-body jet services. Without the wide-body aircraft, Papua New Guinea as a nation would lose a substantial proportion of the commercial air freight services and relevant foreign exchange revenue to the economy.

Without the codeshare, Air Niugini would be forced to become a smaller, less significant, less reliable airline and forced to consider cutting down some of the internal training of pilots, engineers, administrative staff and suspend commercially unsustainable international and domestic routes to maintain profitability. Many jobs would be lost, the economy would lose substantial foreign earnings and businesses such as retail, mining and fishing that rely on importing and exporting goods would be forced to pay substantially more for their air freight, with the flow on consequences of higher prices and lower prosperity throughout the country.

The benefits that Air Niugini’s codeshare arrangements with Qantas deliver to the nation are significant. These benefits and the reasons for them remain substantially the same as in previous submissions.

The importance of wide-body aircraft

Air Niugini has traditionally operated ‘wide-body’ aircraft on its international services.

Wide-body aircraft offer important advantages over narrow-body aircraft including:

- The ability to carry higher volume of freight and containerized freight, critical if an airline is to offer efficient air freight services. Without a wide-body aircraft, Air Niugini would substantially lose the capacity to offer air freight services. For example the B737 could carry around 2 tonnes of loose cargo as against B767 carrying approximately 20 tonnes of containerized and palletized freight.
- As the cargo is carried as supplementary revenue, passenger carriers have the ability to offer lower cargo rates than dedicated freighter service providers. This wide-body aircraft capability to handle cargo becomes more important in PNG as PNG markets heavily rely on fresh food items imported to PNG and the freight
market is more inbound to PNG from Australia with only a small amount of freight outbound. Therefore, freight carriers are not in a position to offer better rates than a wide body passenger operator due to one way freight.

- Wide-body aircraft offer the opportunity to provide better passenger comfort and customer appeal to travelers. In the absence of such a service, customers may opt to travel to Asia via Brisbane to enjoy such services available from other airlines. This will mean that PNG will miss out on significant foreign exchange revenue which will otherwise assist in a positive impact on PNG’s trade deficit and exchange rate.
- Greater range than narrow-body aircraft allowing Air Niugini to offer nonstop direct services to destinations such as Japan and Singapore.¹
- If sufficient passenger loads can be achieved, more efficient operations with lower costs and lower greenhouse emissions per passenger kilometer than a narrow-body aircraft.
- Having a wide-body aircraft operation is important from a network perspective. The same planes that operate to Brisbane also fly to Singapore and Hong Kong. This allows Air Niugini to connect passengers and freight in Port Moresby with destinations beyond, and vice versa. Traffic traveling to or from Honiara and Fiji, in particular, from Asia find Port Moresby transits are convenient.
- Freight is now able to be lifted to locations within PNG utilizing the ATR72 freighter which commenced service in 2013.

The advantages of wide-body aircraft and, in particular, their ability to carry commercial airfreight, 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 independently maintain wide-body aircraft services of the quality and frequency that consumers in Papua New Guinea have come to expect. Air Niugini therefore could not sustain wide-body passenger operations between Papua New Guinea and Australia on its own.

Indeed, by attempting to do so, ICCC is reminded, again that Air Niugini came close to financial ruin once before. In 2001, prior to the Current Codeshare Agreement, Air Niugini reached a position of bankruptcy attempting to sustain a wide-body 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 banks and was almost placed into administration by creditors. Having reached this major financial crisis, the then Board of Air Niugini recognized that the Australia/PNG routes could not continue to sustain two wide-body operators and, as part of its “flight path to recovery” strategic plan, decided to enter into the Current Codeshare Agreement.

Since Air Niugini would be unable to maintain wide-body passenger services between Papua New Guinea and Australia on its own, and since a wide-body 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 wide-body 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 and compete to offer competitive prices and achieve a higher frequency, higher quality service for customers than either could offer on its own.

Due to the significant importance of wide-body aircraft operation in PNG, Air Niugini’s Board decided in 2008 to expand the fleet with commitments to introduce a B787 Dreamliner aircraft in the future and to diversify with the introduction of B737-800 aircraft. The Board has also authorized the refurbishment of its 2 B767 and 3 B737 at a cost of PGK

¹ Some narrow-body aircraft have recently been developed that offer sufficient range to safely operate such sectors. Current Air Niugini narrow body aircraft cannot operate such sectors with full payload.
XX million in 2013-2014. These newer aircraft and refurbished aircraft will offer better customer service and be more competitive. The recovery of such major investment costs can only be made possible with route profitability and sustainability. **This is a major reason to seek a five year approval as against a shorter period to provide higher confidence to the leasing companies and financiers.** In the absence of a long term and continuing code-share agreement, Air Niugini may be compelled to dispose of the equipment causing higher losses to the airline and missed opportunity to travelers in PNG. With the codeshare, both Air Niugini and Qantas can continue to offer high frequency services with better equipment with all the advantages of efficiency, passenger comfort and ability to carry freight that come from a wide-body service 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 recognized potential for delivering a lower seat cost to the operator and lower airfare to the travelling public. Many governments entering Air Service Agreements around the world recognise and endorse codesharing. Further, international developments provide evidence of more than two airlines code-sharing services, in some cases as many as four airlines code-sharing one aircraft service.

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 25 codesharing agreements on various routes on its network, and there are over two hundred code-sharing agreements between the world’s airlines.

Codeshare arrangements typically fall into two broad types:

(a) ‘free sale’ or
(b) ‘hard block’.

Under a free sale codeshare, the marketing carrier only pays the operating carrier for seats if it actually sells them. This kind of arrangement does not promote strong competition as the marketing carrier pays only for what they manage to sell.

By contrast the code-share arrangements between Air Niugini and Qantas, under BLOCK CODESHARE seats are allocated to Qantas on a hard block basis. This means the marketing carrier (QF) must pay the operating carrier (Air Niugini) whether Qantas sells the seats or not. The hard block allocation that Qantas are required to purchase is significantly higher than the number it normally sells. Unsold hard block seats represent an absolute loss to Qantas. Therefore Qantas 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 product through its respective independent sales networks including websites, Global Distribution Systems, Sales Offices and Call centers.

This results in a high level of competition between the carriers. Over the period of the codesharing arrangements between Air Niugini and Qantas, Air Niugini’s fares have generally declined in real terms on both the Brisbane Route and Sydney Route as shown in section 9 below.

Both carriers face effective competition from Virgin Airlines who operate between Port Moresby and Brisbane. Virgin is required to set fare levels independently and therefore to/from Australia there are 3 airlines setting and marketing fares. Papua New Guinea’s “open skies” policy ensures that new entrants can enter the market with no barriers.
Results of loss of the codeshare for Air Niugini and Qantas

Without the codeshare arrangement, Air Niugini considers that Qantas would be likely to commence its own services on the Brisbane Route. Considering the current level of passenger volumes and potential demand it is most likely Qantas would use a narrow body type B737 or Airbus A320 aircraft and not a wide-body service on this route. Air Niugini considers that it is highly unlikely that Qantas would introduce a Port Moresby/Sydney nonstop service due to lack of volume for two independent operators. It is also likely that, in the absence of a codeshare, Air Niugini would be compelled to suspend the current Port Moresby/Sydney service, a service that has been highly appreciated and valued by the traveling public.

Consumers in Papua New Guinea have become used to the Current Codeshare Agreement and high frequency of jet services to Australia. Assuming that Qantas wished to continue to offer high frequency services on the Brisbane Route, 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 wide-body services with this level of frequency. Accordingly, any Qantas service would have to be operated with smaller, narrow-body aircraft. However, even introducing this frequency of narrow-body aircraft would increase the current levels of capacity between Papua New Guinea and the major cities of Sydney and Brisbane by almost 40% (see section 6 below).

With the loss of the codeshare support and the increase capacity on Australian routes from new Qantas services, it is inevitable that continued high frequency wide-body 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, it would incur total additional losses of over PGK XX Million2 per year on the Brisbane and Sydney Routes (see section 6 below).

In the short term, therefore, Air Niugini would seek to reduce its losses by reducing the frequency of its Australian wide-body services to only (2 or 3) per week. Without the codeshare, even this level of service would still result in additional total losses of PGK 9 Million per year on the Brisbane and Sydney Routes (see section 6 below). In the longer term, Air Niugini would have no alternative but to withdraw from wide-body services and replace its B767 aircraft with a narrow-body aircraft with sufficient range to service Air Niugini’s international destinations, such as B737 max.

This would have a significant detrimental impact not only on Air Niugini’s ability to provide air passenger and freight services between Papua New Guinea and Australia, but also to other international destinations such as Singapore and Hong Kong, where wide-body operations are currently used. This kind of a major market upheaval is also unhealthy for current resource development projects, and it is possible that investors may lose confidence in the service providers to materialize their investment outcomes.

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 as a whole. These can be summarized as:

- **Competition in the Australia Air Passenger Market**

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2 Calculated as the difference between estimated average profitability over the course of the codeshare in Projection A in Annexure C (ie, assuming codeshare is approved and services are maintained), and Projection B in Annexure C (ie, assuming codeshare is not approved and services are maintained). These projections are based on the current Route Profitability Report 2014, Annexure D.
The Brisbane and Sydney Routes are currently served by two operating carriers, Air Niugini (Sydney Route and Brisbane Route), and Virgin (Brisbane Route). After the restructure that would follow the loss of the current codeshare arrangements between Air Niugini and Qantas, it is likely that the number of operating carriers on these routes would remain at two (ie, Air Niugini and Virgin), however neither carrier would operate a wide-body aircraft, and neither is likely to offer direct services between Port Moresby and Sydney. The ultimate likely effects on the Brisbane Route and Sydney Route can be summarized as set out in the table below:

<table>
<thead>
<tr>
<th>Operating Carriers</th>
<th>Marketing Carriers</th>
<th>Efficiencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 Air Niugini (PX/QF) BNE/SYD, Virgin BNE</td>
<td>3 Air Niugini Qantas Virgin</td>
<td>Achieve efficiencies of combining traffic on B767</td>
</tr>
<tr>
<td>Likely remain at 2</td>
<td>Likely reduction from 3 to 2</td>
<td>Loss of number of available seats in medium to long term. Loss of wide-body. Less product choice in the market and potential lesser competition.</td>
</tr>
</tbody>
</table>

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

Further details of the effects of the codeshare on competition in the Australian Air Passenger Market are set out in section 8, 9 and 10 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. Further, most of the resource projects expect to air freight their cargo via Asian ports due to high frequency to these locations from China, Europe and USA. The renewed demand from resources sectors too will potentially add more demand to the air freight market.

As described above, by making high frequency wide-body passenger services possible, the code-share also not only enables the provision of high frequency, high efficiency air freight services to and from Papua New Guinea and Australia but also allows the continuation of Asian bound cargo to be moved directly to and from Asia to PNG due to the operation of wide-body aircraft. The air freight movement from Australia generates around PGK 15.2 Million a year (excluding codeshare revenue whilst freight carried on the B767’s from Singapore and Hong Kong to Port Moresby/Australia has increased since 2012, freight carried on the Sydney and Japan routes has fallen since the introduction of the B737’s on these routes after 2012. This is a significant public benefit as a whole and continues to strengthen PNG Foreign Currency Reserves and maintain and strengthen the Kina versus other currency exchange rates. Continuation of Code-share allows Qantas and Air Niugini to sell these services in competition with one another. In the absence of the codeshare the freight business may be operated by other overseas operators and PNG as a country will lose this economic opportunity at a time the resource sector’s future potential demand is very high.

Following the end of the previous codeshare between Air Niugini and Qantas on the Port Moresby to Cairns route and entry by Qantas onto that route in its own right on 1 July 2010, Qantas and Air Niugini each independently operate between Port Moresby and Cairns. Airlines PNG who used to operate this route has ceased services following the entry of Qantas, reducing competition.

In 2012 Air Niugini carried XXXXXXXxKg of freight from Hong Kong, XXXXXXKg from Japan and XXXX Kg from Singapore. In 2014 these figures were, respectively, XXXXXXXKg, XXXXXXKg and XXXXXXXXKg.
As discussed above, the loss of the codeshare would force Air Niugini to cease wide-body services. Since the nation’s air freight is carried almost exclusively by these services, this would leave the nation without the majority of its current air freight services. Capacity will shrink from 96,000 Kgs per week to 14,000 Kgs per week if wide-body services are cut.

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 20%. Alternatively, it is possible (though Air Niugini considers unlikely) that Qantas may take the opportunity to become an independent supplier of air freight services. Either outcome represents a less efficient, less competitive outcome than will result from authorization or the Renewed Codeshare Agreement, where Qantas and Air Niugini compete for the provision of freight services to customers using Air Niugini’s wide-body aircraft.

In addition, without Air Niugini’s international wide-body services, Papua New Guinea would suffer the loss of direct air freight services to any of Japan, Singapore, Hong Kong or the Philippines. This is because if wide-body services are not sustainable for Australian routes, there is insufficient demand for Air Niugini to justify a wide-body service just for Asian routes.

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 section 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

As well as causing significant harm to those sectors of the national economy which rely on air freight services as described above, loss of the codeshare would also result in substantial additional financial losses to Air Niugini on routes between Papua New Guinea and Australia (see section 7). The likely removal of wide-body operations by Air Niugini in the absence of the codeshare is also likely to negatively impact Air Niugini’s profitability on international routes to Asia. Since Air Niugini is a national carrier, any such additional loses represent a direct loss of government funds that would otherwise be available for welfare or infrastructure spending for the benefit of the nation. This will also reduce the share value of Air Niugini and reduce its attraction for investors in the State’s plans for partial privatisation of the airline.

Further, with the loss of codeshare, Air Niugini will become a smaller airline with lower customer volumes to spread fixed costs across. The result may be to increase the business’ 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 are set out at sections 15 and 16.

It is important to highlight that since the last codeshare approval in 2012 Air Niugini has not made a single airfare increase even to cover increases in CPI except for fuel surcharge to cover increases in fuel costs and other surcharges that represent Civil Aviation and Tax authorities imposed levies despite all operating costs around running an airline. Air Niugini not only did not increase airfares but also since year 2006 has introduced various discounted airfares making the travel more affordable to the
domestic and international traveling public. Further, it added more aircraft to its fleet allowing more reliability and frequency in both domestic and internal fronts. This is major achievement by Air Niugini due to the financial stability the code-share arrangement provides primarily to Air Niugini and PNG as a whole as a beneficiary. Loss of the codeshare will create a higher cost of passenger travel and freight costs to the economy which will have an inflationary effect on the PNG economy.

- **Employment**

Loss of authorization would result in the direct loss conservatively 20% jobs immediately unless deployed to other routes and this number may go up to over 25% employees due to the consequential effects of lower revenue. This also will reduce the government's employment related income tax significantly. In its determination A2012/13, ICCC questioned this argument and was of the view that any loss of employment would “not be permanent” on the basis that non-authorisation would generate employment in the “same or other sectors” for example, Qantas may require additional employees or the increased competition may result in an increase in employment in tourism related industries. (page 46).

However, Air Niugini estimates that, it would be forced to bring its workforce close to 1,600 or less employees from its current level of over 2,200. This kind of a significant reduction is expected due to the loss of the code-share which would lead to less traffic staff, less pilots, engineers, flight attendants, catering staff, less domestic traffic and all other staff due to fewer passengers etc and Air Niugini maintains that such significant reduction would be permanent and not temporary as ICCC suggests. The flow effects though the economy of higher air freight costs are also likely to cost many more jobs. This is discussed at section 20 of this submission.

- **Improvements to Services**

The codeshare arrangements with Qantas allow a higher standard of services to be provided to Papua New Guinea consumers in a range of ways. The codeshare has allowed for the introduction of direct services between Port Moresby and Sydney. This service would not be possible without the codeshare. Finally, by making wide-body services to Brisbane possible, the codeshare provides passengers with a smoother ride and, for many passengers, a greater sense of security and wellbeing than narrow-body aircraft.

These benefits are discussed further at Section 18 of this submission.

- **Efficiency**

The wide-body services made possible by combined codeshare operations provide substantial efficiencies compared with the likely attraction of two separate narrow-body 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 flag carrier in a range of ways. This benefit is described at section 21 of the submission.

**Conclusion**

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 authorize these 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 authorization pursuant to section 70 of the Independent Consumer and Competition Commission Act 2002 (ICCC Act) to enter into and give effect to a codeshare agreement (Renewed Codeshare Agreement) with Qantas Airways Limited (Qantas), for a period of five years from 1 October 2015 to 30 September 2020.

The Renewed Codeshare Agreement will be in similar terms to the previous codeshare agreement which expires on 30 September 2015 (the Current Codeshare Agreement). However, in response to previous concerns raised by the ICCC, the Renewed Codeshare Agreement will again involve “hard block” seat allocations only, giving Qantas a strong incentive to aggressively market these seats in competition with Air Niugini. 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 this information could result in material financial loss and prejudice the competitive position of Air Niugini. Air Niugini requests that this information be kept in strict confidence 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 highlighted RED TEXT for confidential text, for a 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 Ms Benneth Kome, Company Secretary of Air Niugini.

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 Guinea government (60%) Ansett (16%) Qantas (12%) and Trans Australia Airlines (TAA) (12%). In 1976 the Papua New Guinea 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 100% owned by Independent Public Business Corporation of Papua New Guinea. Air Niugini is one of Papua New Guinea’s largest and most respected companies. Air Niugini employs over 2200 people worldwide and is Papua New Guinea’s largest airline. This employee number has reduced since the previous submission. Over the last three years the airline has grown thanks to the approval of the code-share previously and has added 3 narrow bodied B737-800’s to the fleet to provide more reliability and travel choices to the traveling public. Air Niugini’s gross turnover in financial year 2011 was around PGK 1.1 Billion.

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 22 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 and Manila. These overseas offices not only
sell tickets to the traveling public, but they also service the needs of the Papua New Guineans who travel overseas and (in many ways) act as de facto Papua New Guinean tourism offices. Additionally, Air Niugini has appointed General Sales Agents who represent Air Niugini and Papua New Guinea's interests in the UK, Italy, Malaysia, Indonesia, Hong Kong, China, Taiwan, the USA, Fiji, Solomon Islands, New Zealand, Singapore, Japan, South Korea and Cebu. Air Niugini provides its own ground handling throughout PNG. Further, it also maintains an engineering facility covering up to “C” check level service for Fokker 100 and Dash 8 Aircraft types and provides line check services for the B767, ATR72, B737 and Falcon Jet aircraft. To carry out these functions the airline employees in excess of 233 employees.

It is important to note since the approval of code-share in 2012, Air Niugini has expanded its fleet, improved profitability but added reliability to provide more improved and competitive service to the traveling public. Direct nonstop services to Sydney twice a week are serviced by B737 aircraft whilst the Brisbane sector is serviced by both B767 and B737.

Air Niugini through its wholly owned subsidiary, Link PNG Limited, operates Domestic services between Port Moresby and 21 Ports throughout Papua New Guinea as shown in Figure 1 below:

In addition to domestic air services as displayed above, 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 20 aircraft: 2x B767, 3x B737, 7x Fokker F-100, 1x F70 jets, 6x Dash Q400 next generation aircraft and one ATR72 Freighter.

Link PNG Ltd, operates 7 Dash 8 aircraft on domestic routes.

2.2  Qantas
About the Qantas Group

Information about Qantas is freely available on Qantas websites and in its reports to ASX, as a public company. Briefly, the Qantas Group comprises two complementary flying brands, Qantas and Jetstar, the Qantas Frequent Flyer and Qantas Freight businesses, and a portfolio of supporting businesses and investments. Qantas is Australia’s largest domestic and international airline and is ranked among the world’s leading premium carriers. Jetstar is one of the world’s fastest growing and most successful low cost carrier brands, operating in Australia, New Zealand, the Pacific and throughout Asia.

The Qantas Group is the world’s eleventh largest airline group by passenger numbers and distance flown. It employs approximately 33,000 people and offers services across a network spanning 98 destinations in 16 countries (including those covered by codeshare partners) in Australia, Asia and the Pacific, the Americas, Europe and Africa. Domestically, Qantas, QantasLink and Jetstar operate around 5,700 flights a week serving 65 city and regional destinations in all states and territories. Jetstar also operates 222 domestic flights per week in New Zealand. Internationally, Qantas and Jetstar operate more than 970 flights each week.

The Qantas Group operates a fleet of 284 aircraft comprising Boeing 747s and 737s, Airbus A380s, A330s and A320s, Bombardier Dash 8 and Bombardier Q400s. Qantas is a founding member of the oneworld alliance.

3. RATIONALE FOR RENEWED CODESHARE AGREEMENT

3.1 Wide-body aircraft – Freight carrying ability and other advantages. This is substantially the same submission that Air Niugini made to ICCC in 2012.

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

In broad terms a “wide-body” aircraft is one with two aisles in the passenger cabin, whereas “narrow-body” aircraft has only one. Examples of narrow-body aircraft are the Airbus 320 and the Boeing 737. 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.

Wide-body aircraft have two aisles and up to 11 seats across the economy cabin. Wide-body 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 by a narrow-body aircraft must be carried ‘loose’. This means loading and unloading freight from a narrow-body aircraft is time consuming and inefficient. Large or heavy freight cannot be carried easily on narrow-body aircraft due to these limitations.

By definition, a wide-body aircraft is always a big aircraft. Well known examples are Airbus, 330, 340 and 380 and Boeing 767, 777, 747 and 787. In addition to the ability to carry commercial air freight, wide-body aircraft offer important advantages over narrow-body aircraft. These include:

- Greater range than a narrow-body aircraft. This allows Air Niugini to provide direct services to distant destinations such as Japan;\(^5\)
- Greater passenger comfort; and
- If sufficient passenger loads can be achieved, more efficient operations with lower costs and greenhouse emissions per passenger than a narrow-body aircraft.

Most of Air Niugini’s long haul international services are operated using 2 leased wide-body Boeing 767-300 series aircraft (the B767). The introduction of 3x B737 has enabled Air Niugini to increase the frequency of services into Australia and to Asia. It now has 2 direct

\(^5\) Some narrow-body aircraft have recently been developed that offer sufficient range to safely operate such sectors.
flights per week to Sydney, 13 to Brisbane, 5 to Singapore and 3 to Hong Kong as well as services to Manila, Honiara and Nadi. Code share has enabled Air Niugini to continue to use its B767 and with the improvements to Jackson’s International Airport and increased passenger capacity, Port Moresby could become the hub for both freight and passenger services not only domestically but to other Pacific Nations.

If Air Niugini were unable to afford to continue to operate these 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 wide-body 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 wide-body operations.

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

In order to sustain wide-body aircraft operations, Air Niugini must achieve maximum utilization of its aircraft across the whole of its international network. The services which account for the greatest proportion of Air Niugini’s wide-body aircraft operations are those between Papua New Guinea and Australia. The viability of continued wide-body 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 proportion of expatriate Australians living in Papua New Guinea and traveling to and from Australia.

In more recent years, both the level of Australian business activity in Papua New Guinea and the number of Australian expatriates living in Papua New Guinea has increased. There are now 8,000 living in PNG but visitor numbers and short term employee numbers have substantially increased.6

However, 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 in making wide-body operations financially viable.

Indeed, in 2001 Air Niugini came close to financial ruin by attempting to sustain wide-body operations in its own right between PNG and Australia. The resulting losses led to a situation where the airline owed many Millions of Kina to major suppliers and was almost placed into administration 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 and B737’s to Qantas for resale. Qantas’ extensive Australian network and customer base mean that it is able to sell seats on Air Niugini’s Australia 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 wide-body aircraft operations viable.

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6 The Australian High Commission in Port Moresby, who maintains a database of Australians registered as living in PNG, has advised that, based on current numbers registered, they estimate there are about 8,000 Australian expatriates currently living in PNG. They also estimate that there are 54,000 Australians entering PNG each year for tourism whilst about 7,500 re-enter each month. Further, other Nationals using the codeshare routes include 30,000 Filipinos, 30,000 Chinese and 25,000 Malaysians.
Without the Renewed Codeshare Agreement, Air Niugini would be forced to withdraw from operating wide-body aircraft. Among other consequence, this means that Papua New Guinea would lose its major 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 authorization to enter into and give effect to the Renewed Codeshare Agreement with Qantas.

4. SUMMARY OF THE CODESHARE AGREEMENT

The current Codeshare Agreement commenced on 1 October 2012 for a term of three years, expiring on 30 September 2015. Key terms for both the existing Current Codeshare Agreement and the proposed new Renewed Codeshare Agreement are as follows:

(a) Air Niugini operates codeshare services with Qantas between Papua New Guinea and Australia on the following routes:

(i) Port Moresby – Brisbane vv (Brisbane Route)
(ii) Port Moresby – Sydney vv (Sydney Route)

Changes in routes may be negotiated between the parties from time to time in response to customer demand and capacity available.

(b) Qantas is allocated blocks of seats for sale to Qantas passengers on each codeshare service. All 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) Air Niugini and Qantas each sells and markets fares on each codeshare service independently through 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 price it charges for fares.

(d) Qantas is also allocated up to 40% of the total aircraft freight capacity on Brisbane B767 routes. All freight allocations are on a hard black basis (i.e. Qantas must pay for its full allocation, whether it fills it or not).

(e) Details of the codeshare services and the hard block passenger and freight allocations on each as at the date of this application are set out in Annexure A.

(f) Details of codeshare services and the hard block passenger and freight allocations proposed under the Renewed Codeshare Agreement will continue at the same level but are subject to change on a seasonal basis. Air Niugini’s comments on what services and allocations are likely to be, in the future are discussed at Annexure B.
PART B

THE FUTURE WITH AND WITHOUT THE CODESHARE AGREEMENT

5. OVERVIEW

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

6. IF AUTHORISATION IS GRANTED

If the renewed Codeshare Agreement is authorized, Air Niugini is likely to be able to continue to provide multiple wide-body B767 servicing on both codeshare routes and other international destinations. The narrow-body B737 provides back up and reliability to customers and, the Sydney direct services could continue. If market conditions improve, Air Niugini may still consider expanding services to Townsville and/or Melbourne, Australia as well.

As a result of the utilization of the B767 made possible by the codeshare, it is likely that Air Niugini will be able to continue to operate this aircraft viably 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 Australian 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 containerized air freight services between Australia and Papua New Guinea in accordance with the schedule outlined in Annexure B;
(c) Qantas and Air Niugini has introduced two nonstop services per week between Sydney and Port Moresby operated by B737 aircraft;
(d) Qantas and Air Niugini will continue to compete in relation to both the prices and terms they offer on both passengers 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 Philippines.

7. IF AUTHORISATION IS NOT GRANTED – AIR PASSENGER SERVICES.

Anticipated Qantas Response

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

It remains a possibility that Qantas may withdraw all air passenger services between Australia and Papua New Guinea. For example, Qantas may consider Papua New Guinea a high risk destination for their aircraft and staff, and decide to withdraw services from the market altogether or, for commercial reasons it may withdraw the service. If this were to occur, the result would clearly be a lessening of competition resulting from the loss of Qantas marketing presence in the Australia Air Passenger Market.

Air Niugini still expects however, that Qantas is likely to respond by commencing operations of its own services between Papua New Guinea and Brisbane. Air Niugini considers that it is highly unlikely that Qantas would introduce a Port Moresby/Sydney nonstop service due to lack of sufficient volume for an independent operator. Those Brisbane services might be Qantas or, alternatively some or all services could 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 wide-body air services. Qantas would therefore be most likely to offer a more frequent service (possibly daily) using a narrow-body aircraft such as a B737 similar to the one currently operated by Virgin or an Airbus 320-200, if Jetstar.

The introduction of such a service would introduce substantially more capacity to the market than that currently available 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 the introduction of total capacity of over 52,416 extra seats per annum in each direction\(^7\) on a route that has a current operated capacity of 120,536 seats per annum.\(^8\) In 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 43%. Even if capacity on the Sydney route is taken into account, the Qantas service would still amount to an increase in total capacity of 38%.

Qantas through the subsidiary carrier Qantaslink commenced services in its own right between Cairns and Port Moresby in July 2010 using a Bombardier Q400 aircraft, ending the previous Codeshare between Air Niugini and Qantas on this route. As a result, APNG ceased services from 7 services per week and Air Niugini has contracted slightly offering 11 services per week. Air Niugini believes that this has had (and will continue to have) a detrimental effect on competition and consumer choice on the Port Moresby to Cairns route in the medium to long term, and both Qantaslink and Air Niugini are struggling to operate profitably on this route.

Air Niugini response – Short Term

**Sydney Route**

If the Renewed Codeshare Agreement is not authorized, as shown in the projections in Annexure C, it would not be viable for Air Niugini to continue direct flights between Port Moresby and Sydney.

As shown at Annexure C the current Sydney Route\(^9\) is now showing a small profit as a result of 12 years of development. Without Codeshare support, it would make losses and be unsustainable, and Air Niugini considers that there is insufficient demand on the Sydney route to maintain an independent operation.

Accordingly, if the Renewed Codeshare Agreement were not to be authorized, Air Niugini would cease to offer the Sydney Route, and would instead only offer the Brisbane Route independently.

**Brisbane Route**

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

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\(^7\) 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.

\(^8\) Current capacity of direct services (i.e. excluding travel via Cairns) operate between Port Moresby and Brisbane is calculated as follows:
- Air Niugini/Qantas (2,318 seats in each direction per week (see Annexure A) x 52 weeks)
- Virgin/Airlines PNG (6 Services each direction per week with 168 seat B737-800 x 52 weeks)
Total capacity of direct services (i.e. excluding travel via Cairns) operated between Port Moresby, and Sydney is as follows:
- Air Niugini/Qantas (302 seats in each direction per week (See Annexure A) x 52 weeks

\(^9\) Despite being profitable in previous years, Air Niugini also made a loss on the Brisbane Route in 2011, which Air Niugini considers reflect the strong degree of competition which already exists under the current codeshare.
In addition, as described in section 7 Anticipated Qantas Response above, in order to provide a jet service with the level of frequency that consumers in Papua New Guinea have come to expect under the Current Codeshare Agreement, Qantas would have to increase total capacity in the market by almost 43%. In the short term, it is possible that this may result in temporary downward pressure on prices as each carrier struggled to attract sufficient customer volumes to make its schedule viable.

In any such “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 a 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

All of these factors mean that, in a world without the Renewed Codeshare Agreement, Air Niugini’s B767 and B737 operations between Papua New Guinea and Australia would incur substantial losses. As shown in Annexure C, if Air Niugini were to attempt to maintain its current level of frequencies, this would be likely to result in Air Niugini incurring total additional losses of over PGK 70 Million\(^{10}\) per year on the Brisbane and Sydney Routes.

In these circumstances, Air Niugini simply does not have the financial resources to maintain 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 to operate wide-body services. In order to minimize its losses however, Air Niugini would have to substantially reduce the number of services it would operate on the codeshare routes. Air Niugini therefore believes that it would be likely to have to reduce its B767 operations to two or three return services per week, concentrated on the strongest traffic days of Monday, Friday and possibly Sunday. Reducing B767 services would also reduce freight capacity.

As shown in Annexure C, this would still be likely to result in additional total losses for Air Niugini’s wide-body aircraft operations of over PGK xx million\(^{11}\) per year on the Brisbane and Sydney Routes.

Air Niugini response – medium to long term.

As noted above, for at least the short term, Air Niugini would have little alternative but to try to maintain wide-body B767 operations between Papua New Guinea and Australia, in order to minimize its losses. However, it would be an unjustifiable drain on national resources for Air Niugini to continue to sustain the additional losses described above 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 minimizing losses would be to negotiate with the lessors of the B767 to be released from its lease of this aircraft.

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\(^{10}\) Calculated as the difference between estimated average profitability over the course of the Codeshare in Projection A in Annexure C (ie, assuming codeshare is approved and services are maintained), and Projection B in Annexure C (ie, assuming codeshare is not approved and services are maintained).

\(^{11}\) Calculated as the difference between estimated average profitability over the course of the codeshare in Projection A in Annexure C (ie, assuming codeshare is approved and services are maintained), and Projection C in Annexure C (ie, assuming codeshare is not approved and services are reduced).
As was submitted in 2012, the previous lessor of Air Niugini’s B767 was very much aware of the importance of Air Niugini’s codeshare arrangements for the viability of Air Niugini’s wide-body operations. As a result, this previous lessor insisted in negotiations with Air Niugini that it must have the right to terminate Air Niugini’s lease of the B767 if the Renewed Codeshare Agreement was not authorized by the ICCC. It was expected however, that the lessor would only have exercised this right if it believed that financial circumstances were such that continuation of the lease would force Air Niugini into liquidation. In circumstances where the B767 would make heavy losses, but not so much that Air Niugini would be forced into liquidation, it was expected that the lessor would not have exercised its right of termination, but would have required Air Niugini to negotiate to ‘buy out’ the lease of the B767. It is likely that this may have involved a significant cost to Air Niugini. There is no doubt that similar concerns and consequential negotiations would occur if the Renewed Codeshare Agreement is not again authorized.

Air Niugini would then replace its B767 with one of the few narrow-body aircraft with sufficient range to service Air Niugini’s international destinations, such as a long range version of Boeing’s 737 making the airline again as previously experienced a one aircraft operator and at much higher risk of being unreliable.

The restructuring to narrow-body aircraft would also affect Air Niugini’s passenger services to Asian destinations, as its current use of a wide-body aircraft enables Air Niugini to offer competitive connections to Australia and the Pacific. This capability also means that the airline is not solely dependent on the traffic to and from PNG.

8. IF AUTHORISATION IS NOT GRANTED – AIR FREIGHT SERVICES

Short Term

Qantas

For reasons described in section 7 above, Air Niugini expects that Qantas would be likely to commence its own services between Australia and Papua New Guinea with narrow-body aircraft if the Renewed Codeshare Agreement is not authorized. Since narrow-body aircraft are unable to carry containerized 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 and the amount invested in the refurbishment of its Boeing fleet, it would have no alternative in the short term but to continue to operate wide-body 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, which would be substantially reduced compared to the services able to be offered if the Renewed Codeshare Agreement is authorized.

Medium to Long Term

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

Since narrow-body aircraft cannot carry containerized freight, Air Niugini would be forced to substantially withdraw from the provision of air freight services. Air Niugini would therefore cease to provide air freight services between Papua New Guinea and any of Australia, Hong Kong or Singapore. This is because if wide-body services are not sustainable for Australian routes, there is insufficient demand for Air Niugini to justify a wide-body service just for Asian routes.

Air Niugini’s capability to compete to carry freight from Asia to Australia or the Pacific via Port Moresby provides Air Niugini with access to a revenue stream which is not solely dependent on the PNG market. These are larger markets than PNG and Air Niugini can
offer competitive prices to improve our market share and overall profitability. This revenue will be lost if restructuring led to the replacement of the wide-body aircraft with a narrow-body aircraft.

In the Australian Air Freight Market, there would be two potential market results from the withdrawal of Air Niugini from the provision of containerized 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 narrow-body 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 wide-body 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 further penetration into the market of dedicated freighter aircraft. However, for reasons explained in section 13 Medium to Long Term 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 (but air Niugini considers unlikely) that Qantas may elect to use wide-body aircraft for one or more of its Papua New Guinea services. This would provide at least some wide-body 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 more 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, Singapore or Hong Kong.
PART C
COMPETITIVE ANALYSIS

9. RELEVANT MARKETS AND APPROACH TO MARKET DEFINITION

Air Niugini submits that the relevant immediate 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 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 D to this submission.

10. COMPETITION IN AIR PASSENGER MARKET – WITH CODESHARE

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;

(b) through Virgin and low barriers to entry of other carriers, 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 details below.

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 airline activity and is widespread in the industry. It allows airlines to maintain a presence in a market where their own operation would not be sustainable. In the modern aviation industry, codesharing is common and recognizes the potential for delivering a lower seat cost to the operator and lower airfare to the consumer. Many governments entering into Air Service Agreements around the world recognize and endorse codesharing.
Qantas operates in a more mature and developed market than Air Niugini and yet still relies significantly on codesharing. 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 was attached as an Annexure to our submission in 2007.

Codeshare arrangements typically fall into two broad types:-

(a) ‘free sale’
(b) ‘hard block’

Under a free sale codeshare, the marketing carrier only pays the operating carrier for seats if it actually sells them. This is a less competitive arrangement as the marketing carrier has less incentive to sell and be competitive.

By contrast, under the Qantas/Air Niugini codeshare arrangements, Qantas is allocated blocks of seats for sale on each codeshare service. All 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 recognized 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 price;
(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 including websites.

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.

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, generally declined on the Brisbane and Sydney Routes over the course of the codesharing arrangements between Air Niugini and Qantas. This is illustrated in Table 1 below. (In each figure, the line graph shows the unadjusted average return fare across all cabins and the bar graph shows the average return fares across all cabins adjusted for changes in Papua New Guinea CPI).
Demand on the routes increased during the latter part of the LNG project in 2011-2012 then declined as construction was completed towards the end of 2013 then increased in 2014 due to the Manus Island Detention Centre project.

The effectiveness of competition in the Australia Air Passenger Market is also reflected in the changes in market share over the life of the Current Codeshare Agreement on the Brisbane and Sydney Routes. As shown in Table 2, the market share has changed from year to year as each market participant has jostled to win market share from others.
No constraining of capacity

As with many markets, competition in airline markets is driven substantially by capacity. The higher 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.

Summaries of the average overall load factors achieved on each codeshare route over the life of the Current Codeshare Agreement are set out in Table 3 below. Table 4 depicts current block seat allocations and Table 5 shows the increase in capacity since 2012.

These figures show that the codeshare arrangements have not had the effect of constraining capacity on any codeshare routes in any significant way.

Table 3 - Breakdown of the market share for Sydney and Brisbane routes:

Port Moresby-Brisbane Route
Port Moresby-Sydney Route

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Table 4 - Block Seat Allocations
Table 5
Capacity increased in 2012-2015 due to the codeshare on the POM-BNE route for all three operators, PX, QF and VA

<table>
<thead>
<tr>
<th></th>
<th>Air Niugini</th>
<th>Qantas</th>
<th>Virgin</th>
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</table>

Other Competitors

In addition to competition between themselves, Air Niugini and Qantas face effective competition in the Australia Air Passenger Market and Virgin Airlines, 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.

Virgin

Virgin commenced operations in 2008 using a B737-800 on the Port Moresby – Brisbane route. This service is available 6 days a week.

As shown in Table 3, Air Niugini estimates that Virgin has captured around 30% of passenger volumes on this route, which represents substantial growth. When combined with the absence of barriers to entry or expansion in the Australia Air Passenger Market (see Low barriers to entry and potential competitors ready to enter below), this suggests that Virgin is likely to have a powerful effect in competitively constraining both Air Niugini and Qantas during the term of the Renewal Codeshare Agreement.

In its 2012 Determination A2012/13, ICCC noted that:

In the recent past, the Commission notes the competition in the provision of air transport services between PNG and Australia has been improving but the trend has generally been weak. Since the entrance of APNG and Virgin, the fares have
been more competitive and the frequency of services has been increased and the customers were given increased choice.

Virgin has continued to be competitive with the determination and resources to compete effectively in the Australia Air Passenger Market. This company has targeted leisure passengers, with aggressively priced leisure fares, and business passengers, with a range of business oriented promotions. For example Virgin has:

- targeted Air Niugini corporate customers in both Papua New Guinea and Australia;
- targeted the adventure market, offering aggressively priced fares to wholesalers of Kokoda trekking and dive holidays;
- offered business incentives;
- offered travel agents and managers incentives;
- targeted FIFO mining workers.

Air Niugini continues to compete with the discounts offered by Virgin, though Air Niugini has generally tended to offer fares slightly above Virgin because Air Niugini still offers a full service in-flight product. Air Niugini has not engaged in conduct aimed at forcing Virgin to withdraw from the market or behaved in an uncompetitive 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.

There is growing demand for charter work, including on routes where there are already regular passenger services offered (eg, to destinations such as Lihir), where contracts are awarded to different operators on the basis of product and price.

Lower 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 for 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, Brisbane or Sydney airports that would be likely to hinder the entry of 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 entry to the market of Virgin Airlines which has been described in more detail above.
In particular:

(a) Virgin Blue entered the market commencing in November 2008 with a codeshare operation with Airlines PNG. Although Virgin and Airlines PNG pitched their services on peak business travel days between Brisbane and Port Moresby, they also pitched fares at the cheaper end of the market;

(b) The Commission noted in September 2006 in its report entitled Papua New Guinea Tourism Sector Review and Masterplan 2007 – 2017 that there were suggestions of a further new entrant on the Port Moresby and Cairns route;\(^\text{12}\)

(c) A range of other companies, such as 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 positioned to enter the market between Australia and Papua New Guinea if Air Niugini and Qantas were to raise prices to make more than normal levels of profit.

11. **COMPETITION IN AIR PASSENGER MARKET – NO AIR NIUGINI/QANTAS CODESHARE**

If the Renewed Codeshare Agreement is not authorized, Air Niugini expects that Qantas would commence its own services in the Australia Air Passenger Market. For reasons described in Section 7 Air Niugini response – Short Term this would be likely to trigger an unsustainable short term price and capacity “battle” as each carrier sought to attract sufficient passenger volumes to make its services viable.

In the long term, it is inevitable that Air Niugini would need to withdraw capacity to become a smaller, less significant operator on codeshare routes. Although 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 wide-body B767 on the codeshare routes, and attempt to attract as many customers as possible to minimize the losses of its wide-body operations.

This means that, until Air Niugini could withdraw from wide-body operations and reduce its costs by substituting a narrow-body aircraft on the codeshare routes, average fares on the routes would be likely to fall and based on our projections result in significant additional losses for Air Niugini.

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 would represent a direct loss to the people of Papua New Guinea. Government backing, however, means that Air Niugini would be likely to ultimately survive until such time as it could stem those losses by withdrawing from wide-body operations.

Such a contraction and restructure would mean that as the National Carrier, Air Niugini would lose its significance in other markets such as Singapore, Hong Kong, Philippines and Japan. Carrying PNG’s flag to these other countries is important for the identity of PNG as a country, and the loss of wide-body operations would render Air Niugini a less important regional carrier, and diminish PNG’s image in the region.

It is evident that Airlines of PNG has withdrawn from competing on the Port Moresby to Cairns route since the previous Codeshare between Qantas and Air Niugini ended on this route and Qantaslink commenced its own services in July 2010.

Although Virgin is a larger player with more resources than Airlines PNG, but it is much smaller than Qantas. Virgin would be expected to aggressively compete in the short term to attempt to sustain passenger loads in the market.

\(^{12}\) At page 71.
<table>
<thead>
<tr>
<th>Operating Carriers</th>
<th>Marketing Carriers</th>
<th>Efficiencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>With Codeshare</td>
<td>2 Air Niugini (PX/QF)</td>
<td>Achieve efficiencies of combining traffic on B767</td>
</tr>
<tr>
<td></td>
<td>BNE/SYD Virgin BNE</td>
<td></td>
</tr>
<tr>
<td>Without Codeshare</td>
<td>Qantas</td>
<td>Loss of wide-body capacity, high losses due to lease</td>
</tr>
<tr>
<td></td>
<td>Virgin</td>
<td>terminations, restrict to B737 service.</td>
</tr>
<tr>
<td>Effect of loss of</td>
<td>Likely to remain at 3</td>
<td>Loss of number of available seats in the medium to</td>
</tr>
<tr>
<td>Codeshare</td>
<td>Likely reduction</td>
<td>long term. Loss of wide-body capacity, high losses</td>
</tr>
<tr>
<td></td>
<td>from 1 to none on SYD</td>
<td>due to lease terminations, restrict to B737 service.</td>
</tr>
<tr>
<td></td>
<td>route.</td>
<td></td>
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</tbody>
</table>

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

12. COMPETITION IN AIR FREIGHT MARKETS – WITH CODESHARE

Overview

The use of a wide-body 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 Codeshare Agreement oblige Qantas to purchase half of Air Niugini’s available air freight capacity on wide-body 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.

Air Niugini has observed the following in respect of current codeshare operations, and expects these to continue under the Renewed Codeshare Agreement:

(a) the high frequency wide-body 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 half of all available air freight capacity on all wide-body codeshare services, on average it achieves less than 100% utilization 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, with the relative shares of sales varying 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 6 below. As shown in that table, there had been a decline in average freight yields over the course of the Current Codeshare Agreement on freight carried from PNG to Australia, however average freight yields from Australia to PNG have fluctuated and are higher than for PNG to Australia. Factors contributing to this include the following:

- A recovery in activity in the mining industry and consequent demand for delivery of mining equipment in PNG has driven higher loads and yields for freight from Australia to PNG.
- Yield mixes have changed over the life of the Current Codeshare Agreement, with higher proportions of general cargo displacing perishable cargo from Australia to
PNG. Since perishable cargo (e.g. fruit) typically has a lower yield than general cargo, this change in mix has led to higher average yields from Australia to PNG.

**Table 6 – Freight Yields**

<table>
<thead>
<tr>
<th></th>
<th>Air Niugini</th>
<th>Qantas</th>
<th>PAE</th>
<th>VA</th>
</tr>
</thead>
<tbody>
<tr>
<td>BNE/POM</td>
<td>6’468’800Kg</td>
<td>3’203’200 Kg</td>
<td>1’872’000 Kg</td>
<td>624’000 Kg</td>
</tr>
<tr>
<td>SYD/POM</td>
<td>416’000Kg</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**Table 7 – Percentage of Freight**

<table>
<thead>
<tr>
<th></th>
<th>Air Niugini</th>
<th>Qantas</th>
<th>PAE</th>
<th>VA</th>
</tr>
</thead>
<tbody>
<tr>
<td>BNE/POM</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SYD/POM</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Table 8 – Current Load Capacity**

<table>
<thead>
<tr>
<th>Capacity/annual</th>
<th>Air Niugini</th>
<th>Qantas</th>
<th>PAE</th>
<th>VA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015 BNE/POM</td>
<td>6’468’800Kg</td>
<td>3’203’200 Kg</td>
<td>1’872’000 Kg</td>
<td>624’000 Kg</td>
</tr>
<tr>
<td>2015 SYD/POM</td>
<td>416’000Kg</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**Lower 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 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 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 minimize 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 readily able to ramp up freight operations between Australia 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

Short Term

As described in section 8, if the Renewed Codeshare Agreement were not authorized:

(a) Air Niugini would continue for a period to offer wide-body 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 authorized;

(b) Unless Qantas determined to recommence their own services, they would be forced to substantially withdraw from the provision of air freight between Papua New Guinea and Australia; and

(c) Pacific Air Express (PAE) may increase its current market share from 28%.

This means that, in the short term, Air Niugini would be likely to be one of two 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.

Medium to Long Term

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

(a) Papua New Guinea would be forced to rely on the entry of dedicated air freighters such as PAE to service the nation’s air freight needs; or

(b) Qantas may take the opportunity to become the primary air freight provider to Papua New Guinea by electing to use a wide-body aircraft for one or more of its Papua New Guinea services. This would provide at least some wide-body capacity to Papua New Guinea.

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

In comparison with freight carried in the belly hold of wide-body 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 belly hold of passenger aircraft can be provided at a much lower cost than possible with dedicated “freight only” services.

(b) Papua New Guinea 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 freighter 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 wide-body passenger based service in the same way because the costs of such a service are largely underwritten by passenger revenue, which is much less directional.13

(c) A dedicated freighter must also operate a much lower frequency of service than a wide-body passenger based service because, unlike the passenger based service, a dedicated freighter must wait to fly until it anticipates its hold will be full or close to full.

13 That is, because over time, nearly all passengers travel on a return basis.
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 authorized.

Air Niugini calculates that in order to be viable, a dedicated freighter would have to recover an average of at least AUD 5.60/kg for air freight in each direction between Australia and Papua New Guinea. 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 AUD xxx/kg.

For the following reasons, the position is not likely to be much better if Qantas were to introduce at least some wide-body capacity to the market:

1. The level of capacity potentially supplied to the market by Qantas would be a fraction of the capacity supply to the market if high frequency wide-body services were to continue. Pressure on Qantas to price its services competitively would therefore be much less than if the Renewed Codeshare Agreement were authorized; 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 wide-body 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 authorize 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 authorized.

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14 This estimate assumes the use of a B737 freighter with an operating cost of AUD xxx per block hour, achieving average freight load factors of 62% and applying a mark up on direct operating costs of just 7% 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 establishing a viable freighter business may be significantly higher.

15 That is, 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 nine frequencies per week under the codeshare. Air Niugini believes even this level of freight capacity is unlikely.
Part D – 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 Guinea economy, including avoiding additional direct losses being incurred by Air Niugini (and consequently the PNG government) on the Brisbane and Sydney Routes, and likely loss of profitability by Air Niugini on Asian routes, if the codeshare is not authorized and wide-body services are ceased;

(b) Provision of cheaper, more frequent and more efficient air freight services through the continued operation of wide-body services, with consequential benefits to those parts of the economy which rely on air freight services;

(c) Access to markets beyond the Australian Air Passenger Market and the Australian Air Freight market, where Air Niugini can provide services to the public and earn additional revenue by competing passengers for passengers and freight in Asia or the rest of the world, destined for Australia or the Pacific;

(d) More efficient use of resources through allowing the use of wide-body aircraft on codeshare routes with lower per passenger costs and lower greenhouse emissions than the duplicated narrow-body 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 wide-body rather than narrow-body aircraft; and

(i) A strong, more capable flag carrier for the nation.

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

15. AVOIDANCE OF ADDITIONAL LOSSES TO PAPUA NEW GUINEA GOVERNMENT

As set out in Section 7, if the Renewed Codeshare Agreement is not authorized Air Niugini is likely to have to significantly reduce the frequencies of its wide-body services on the codeshare routes, until such time as it is able to restructure its operations to withdraw from wide-body operations completely. As shown in Annexure C, this would still be likely to result in additional total losses of over PGK xx Million per year on the Brisbane and Sydney Routes. These additional losses represent a direct loss of funds that would otherwise be available to the government to use elsewhere for the benefit of the nation.

Further, once Air Niugini was able to restructure its operations to only use narrow-body services, the profitability of Air Niugini’s services to Asian destinations is also likely to be adversely affected, including from the loss of revenue from direct air freight services to any of, Singapore or Hong Kong (see sections 16 and 17 below). This is because if wide-body services are not sustainable for Australian routes, Air Niugini considers that there is insufficient demand for Air Niugini to justify a wide-body service for only Asian routes.

16. BENEFITS TO PNG ECONOMY AND BALANCE OF PAYMENTS

Since 2003, the Papua New Guinean economy has enjoyed some degree of recovery from the difficult days of the late 1990s and early 200’s. However, the road ahead still holds...
many challenges. Despite the fact that LNG revenue has been enthusiastically received, there are many areas demanding huge capital investment in infrastructure. A steady course with responsible fiscal management is needed to ensure the benefits flow to the nation as a whole.

In this context, the foreign earnings provided by Air Niugini 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.

With the loss of the codeshare, Air Niugini is likely to become a smaller airline with less flying to speed fixed costs factors. The result may be to increase the business’s break even domestic and international prices. This may lead to increase 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.

Under the Renewed Codeshare Agreement, travel and cargo import costs are likely to be maintained or reduced. If the Renewed Codeshare Agreement is not authorised, Air Niugini considers that this is likely to ultimately cause prices to rise, and will result in inflation.

As described above, by making high frequency wide-body passenger services possible, the code-share also not only enables the provision of high frequency, high efficiency air freight services to and from Papua New Guinea and Australia but also allows the continuation of Asian bound cargo to be moved directly to and from Asia to PNG due to the operation of wide-body aircraft. Air Niugini estimates that air freight movement from Australia generates around PGK xx Million a year (excluding codeshare revenue) whilst Asian routes generate around PGK xx Million a year. This is a significant public benefit as a whole and continues to strengthen PNG Foreign Currency Reserves and maintain and strengthen the Kina versus other currency exchange rates.

If the Renewed Codeshare Agreement is not authorized and Air Niugini is forced to withdraw from this business, this revenue will be likely to flow instead primarily to foreign owned carriers, with a consequential 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 authorized will be cheaper and of higher quality than the services likely to be available if the Renewed Codeshare Agreement is not authorized. 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 of Papua New Guinean industry. Conversely, increases the cost of air freight make Papua New Guinea less competitive in international markets and impose a cost impost on the whole economy.

For reasons set out in section 8 and 11 of this submission, the likely result for air freight services from the 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 direct air freight services currently provided by Air Niugini’s wide-body services. All air freight to and 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 belly hold of Air Niugini’s wide-body services. On the export side, important industries such as Papua New Guinea’s fishing industry (e.g., tuna, prawns, barramundi and crocodile skins) depend heavily for their export earnings on the availability of competitive international air freight services, and would be particularly affected by price increases and service reduction in air freight.

18. IMPROVEMENTS TO SERVICES AND CUSTOMER CHOICE

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

(a) Direct Sydney Services. As advised in our previous submissions in 2012 and referred to in section 6 of this submission, if the Renewed Codeshare Agreement was authorized, Air Niugini would continue nonstop services to Sydney. These provide significant benefits to travelers and make travel to Papua New Guinea more attractive for both business and leisure travelers from Sydney.

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

(c) Degree of customer choice of fares and services. As set out above, the structure of the codeshare is such that Qantas and Air Niugini compete vigorously with each other to sell seats on codeshare flights (as well as other competing carriers on the route), resulting in each marketing carrier striving to develop a wider range of innovative fare initiatives or frequent flyer enhancements to attract more passengers.

(d) Onward route possibilities. The extensive domestic and international networks of Qantas and Air Niugini mean that customers traveling on codeshare routes have enhanced access to convenient connections on domestic or international flights.

(e) Additional flights. Air Niugini will utilize the increased capacity and efficiency of the new Jackson’s International Terminal to connect passengers utilizing the codeshare routes services with other Pacific and Asian destinations and is discussing possible codeshare with Solomon Islands Air, Air Vanuatu and Air Pacific.

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 wide-body services with narrow-body services between Australia and Papua New Guinea.

A wide-body aircraft provides lower passenger costs and results in lower per passenger greenhouse gas emissions than carrying the same number of passengers on duplicate narrow-body services. Accordingly, failure to authorize 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 authorized.
20. **LIKELY EFFECTS ON EMPLOYMENT**

Likely shorter term effects of loss of codeshare

The short term effect of loss or termination of Air Niugini’s codeshare arrangements with Qantas is that Air Niugini would be forced to at least halve the number of wide-body 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. *Air Niugini currently has xx pilots and xx cabin crew employed for the B767 aircraft operations.* It is expected that these numbers would be reduced by at least 20% with the loss of the codeshare within a reasonably short time.

Flow on job losses would also be likely to result from the reduction in requirements for a range of support services such as catering (Currently xx Staff), ground handling (Currently xx Staff) and cargo (Currently xx Staff).

It is also possible that Qantas may terminate its ground handling agreement with Air Niugini in Port Moresby despite ICCC’s assumption in A2012/13 that this may not occur. This would be likely to lead to further job losses.

If Air Niugini is forced to withdraw from wide-body aircraft operations altogether, it is likely that as many as 100 jobs would be lost directly from the operation of this aircraft alone, as follows:

- 15-20 Tech Crew;
- 20-30 Cabin Crew;
- 50 Catering staff; and
- A number of other support staff.

In addition, since Air Niugini would be forced with the 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 1,600 employees from its current level of around 2,200 and that those losses will be permanent not temporary as ICCC suggested in A2012/13.

21. **NATIONAL FLAG AIR CARRIER**

Air Niugini continues to maintain that the support provided to its wide-body operations by its codeshare arrangements with Qantas underpin the strength of Air Niugini as the nation’s national carrier in a range of ways. That is, there is a public bond that derives from “the concept of a national carrier” (ICCC 2012/13 page 47).

The ICCC doubted in 2012 that in times of crisis Air Niugini would be the only airline to attend to the immediate needs of those Papua New Guineans affected.

Whilst that may be the case, Air Niugini as the national flag carrier has an important function to fulfill in non-crisis times as well. For example, it will be the official South Pacific Games Carrier for the 2015 Games and has engraved the Games Logo on 3 of its aircraft. See Media Release and photo at Annexure “F”. The airline also assisted with the PNG Games in November 2014 when more than 2,000 athletes from 22 provinces met in Marobe Province.

That is, as ICCC observed in 2012, “there are wider public benefits to PNG from a viable national flag carrier that services both the domestic and international aviation needs of PNG...”.
ANNEXURE A

AUSTRALIAN SERVICES AND HARD BLOCK ALLOCATIONS
UNDER THE CURRENT CODE SHARE AGREEMENT

Code Share Services

<table>
<thead>
<tr>
<th>Service</th>
<th>Weekly Frequencies</th>
<th>Aircraft</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brisbane Route</td>
<td>16 (8 return trips)</td>
<td>B767</td>
</tr>
<tr>
<td></td>
<td>10(5 return trips)</td>
<td>B737</td>
</tr>
<tr>
<td>Sydney Route</td>
<td>4 (2 return trips)</td>
<td>B737</td>
</tr>
</tbody>
</table>

Code Share Services – Freight

Current Code Share Services with a Schedule Commencement 29th of March 2015.

A. Air Niugini Operated Flights

1. Code Share Services – Brisbane Northbound

<table>
<thead>
<tr>
<th>Flight Number</th>
<th>Route</th>
<th>Days</th>
<th>Aircraft type</th>
</tr>
</thead>
<tbody>
<tr>
<td>PX 6/QF351</td>
<td>BNE/POM</td>
<td>1,2,3,4,5,6,7</td>
<td>B767/B737</td>
</tr>
<tr>
<td>PX 4/QF349</td>
<td>BNE/POM</td>
<td>1, 2, 3, 4, 5, 7</td>
<td>B767</td>
</tr>
</tbody>
</table>

2. Code Share Services – Brisbane Southbound

<table>
<thead>
<tr>
<th>Flight Number</th>
<th>Route</th>
<th>Days</th>
<th>Aircraft type</th>
</tr>
</thead>
<tbody>
<tr>
<td>PX 3/QF350</td>
<td>POM/BNE</td>
<td>1, 2, 3, 4, 5, 7</td>
<td>B767</td>
</tr>
<tr>
<td>PX 5/QF352</td>
<td>POM/BNE</td>
<td>1,2,3,4,5,6,7</td>
<td>B767/B737</td>
</tr>
</tbody>
</table>

3. Code Share Services – Sydney Northbound

<table>
<thead>
<tr>
<th>Flight Number</th>
<th>Route</th>
<th>Days</th>
<th>Aircraft type</th>
</tr>
</thead>
<tbody>
<tr>
<td>PX 2/QF313</td>
<td>SYD/POM</td>
<td>1, 6</td>
<td>B737</td>
</tr>
</tbody>
</table>

4. Code Share Services – Sydney Northbound

<table>
<thead>
<tr>
<th>Flight Number</th>
<th>Route</th>
<th>Days</th>
<th>Aircraft type</th>
</tr>
</thead>
<tbody>
<tr>
<td>PX 1/QF312</td>
<td>POM/SYD</td>
<td>5,7</td>
<td>B737</td>
</tr>
</tbody>
</table>

The Cargo Capacity

On each of the Brisbane/Port Moresby vv and Sydney/Port Moresby vv Code Share Services, Air Niugini will provide to Qantas the following volumetric cargo capacity pallets – PP and DQF containers (DQF) and loose freight capacity:
ANNEXURE B

PROPOSED CODESHARE SERVICES
UNDER RENEWED CODE SHARE AGREEMENT

If authorization is granted, the Renewed Code Share Agreement is likely to include the following Code Share services:

(a) Port Moresby to Brisbane B767-300 Mon, Tue, Wed, Thu, Frix2, 2x Sun
(b) Brisbane to Port Moresby B767-300 Mon, 2x Tue, Wed, Fri x2, Sat, Sun
(c) Port Moresby to Brisbane B737 Mon, Tue, Wed, Thu, Sat
(d) Brisbane to Port Moresby B737 Mon, Wed, Thu x2, Sun
(e) Port Moresby to Sydney B737-800 Fri, Sun
(f) Sydney to Port Moresby B737-800 Mon, Sat

It is anticipated that the current block (all Hard Block) between Port Moresby and Brisbane and Sydney will remain similar to current allocations.

Air Niugini anticipates that if the Renewed Code Share Agreement is authorized then the cargo capacity sharing arrangement discussed in Sections 8, 12, 13, 17 and defined in Annexure A would continue in very similar terms.
ANNEXURE C

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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 foods or services are supplied (the geographic dimension).

2. MARKET DEFINITION – PASSENGER AIR SERVICES MARKETS

2.1 Product dimension

The ICCC has previously accepted that there are two distinct product markets for air passenger services and freight service services.17

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).

The ICCC did not distinguish between business and leisure customers in its market analysis in Determination A 2007/06 and Determination A2008/07. In A2009/9, the ICCC commented that, without analyzing the issue in detail, it considered the separation of cabin classes and fares and fare types for business and leisure customers as indicating the existence of a number of separate sub-markets within the overall product market for air passenger services.

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

This application proceeds on the basis that it is not necessary to define or analyse separate functional levels within the air passenger services market. In Determination A2009/9, the ICCC indicated that there is likely to be one functional level which exists within the overall market of passenger services between Papua New Guinea and each international destination.

2.3 Geographic dimension

Air Niugini submits that relevant geographic markets for international air passenger service are country to country between:

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

17 See for instance the ICCC’s determination on the authorization of the renewed code share agreement between Air Niugini Limited and Qantas Airways Limited, A2007/06.
(b) Papua New Guinea and each of the other international destinations currently services by Air Niugini B767 aircraft (together, the Asian Passenger Air Services Markets).

This is consistent with Determination A2009/9, in which the ICCC stated that it was necessary to bundle codeshare routes as a collective market within specific geographical settings, holding that the codeshare routes in that authorization formed part of a larger market between Papua New Guinea and Australia.\(^{18}\)

3. FREIGHT MARKETS

3.1 Product dimension

Air Niugini submits that there is a single product market for air freight services. This is consistent with Determination A2007/06, in which the ICCC accepted there are two distinct product markets, air passenger services and air freight services between PNG and Australia and between PNG and Asia.

In Determination A2008/07, the ICCC considered that there may be varying freight sub-markets, but that there is "little distinction" between them such that they form part of a larger market for freight service between Australia and PNG.\(^{19}\)

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.

In Determination A2009/9, the ICCC noted that “the markets for ancillary services would not by itself be a significant issue”, concluding that there is likely to be one functional level which exists within the overall market of passenger services between Papua New Guinea and each international destination.

Consequently, 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

The significant majority of 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 routines 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 services by Air Niugini B767 aircraft (together, the Asian Air Freight Markets).

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\(^{18}\) See also Determinations A2007/06 and A2008/07.

\(^{19}\) See also Determination 2009/9, in which the ICCC ultimately concluded that the relevant principal market was the Australian Air Freight Market.
This is consistent with Determination 2009/9, in which the ICCC concluded that it was necessary to bundle codeshare routes as a collective market within specific geographical settings, holding that the code share routes in that authorization formed part of a larger market between Papua New Guinea and Australia.\textsuperscript{20}

\textsuperscript{20} This is consistent with the ICC’s earlier Determination A2007/06, in which it accepted that the relevant freight market was the “market for air freight services between Australia and PNG”.
MEDIA RELEASE

AIR NIUGINI PROMOTES 2015 PACIFIC GAMES.

Papua New Guinea’s national airline, Air Niugini has taken a major step in promoting the 2015 Pacific Games by engraving the games logo on three of its aircraft.

The popular yellow lagatoi with red, green, black and blue colors capturing the spirit of the games and Papua New Guinea is visible on Air Niugini’s two Boeing 737 and a Fokker 100 aircraft.

Air Niugini Board Chairman, Sir Fred Reiher said the 2015 Pacific Games is a momentous regional event that will coincide with the country’s 40th anniversary and Air Niugini as the national airline is happy to be able to participate in a big way.

“Air Niugini has one and a half years to promote the Pacific Games and Papua New Guinea to the rest of the world and the airline is proud to be able to promote this momentous occasion prior to the actual event.”

The three aircraft with the Pacific games logo will be promoting the games in the regions that the airline operates to including Australia, Asia and the Pacific well ahead and in time for the games next year.

I also understand that under Air Niugini’s fleet modernization program, the airline has upgraded all aircraft with the final one completed in March this year.

As the official carrier of the 2015 Pacific Games, the retrofit lifts Air Niugini and Papua New Guinea standards in air travel. It ensures a much higher standard and comfort for customers travelling on Air Niugini Bird Of Paradise services- and what a timing to coincide with the 2015 Pacific Games.

Once again, congratulation and well done, Air Niugini!

Ends... ///