INDEPENDENT CONSUMER & COMPETITION COMMISSION

DETERMINATION

and

REASONS

on

Authorisation Application

lodged by

Air Niugini Limited

in respect of a

Passenger and Freight Code-Share Agreement with Qantas Airways Limited for Port Moresby-Brisbane and Port Moresby-Sydney Routes

Public Register Number	: A2015/18
Date of Registration	: 28 April, 2015
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About the ICCC

The ICCC is a statutory body established under the provisions of the *Independent Consumer and Competition Commission Act 2002* to promote competition and fair trading, regulate prices of certain declared goods and services, and to protect consumers' interests, and other related purposes.

The ICCC is empowered under the *ICCC Act* to have one full time Commissioner and two part time Commissioners which form the ICCC's Board. At the time of this Determination, the Board was comprised of:

Mr. Paulus Ain,	**Commissioner and Chief Executive Officer**
Dr. Eric Omuru, PhD,	**Associate Commissioner (Resident)**
Mr. Edward Willett,	**Associate Commissioner (Non-Resident)**

Please note that as required under the ICCC Act, all submissions and/or comments received by the ICCC from all the stakeholders on this application are made available for public inspection unless the Commission, based on a request from the relevant stakeholder(s), considers that all or part(s) of the submission should remain confidential. However, the ICCC intends to make the review of this application as transparent as possible; and hence the submissions/comments are normally available for public inspection unless there are exceptional commercial-in-confidence reasons as to why submissions should be held in confidence.

1. EXECUTIVE SUMMARY

1. Air Niugini Limited applied to the Independent Consumer and Competition Commission ("ICCC") for authorisation to renew the current authorizations to continue code-share services in accordance with the existing code-share agreement it has with Qantas Airways Limited.

2. Under this code-share agreement, the code-share services are operated between Port Moresby, PNG, and Brisbane and Sydney, Australia. The Port Moresby/Brisbane leg covers both passenger and freight services while Port Moresby/Sydney is only for passenger services.

3. ANL and Qantas began this code-share agreement since 2002. ANL has since been applying for authorisation from the ICCC for renewals of authorisation. This application is for another renewal of the authorisations for this code-share agreement which the ICCC granted authorisation separately for passenger and freight code-share, but were to expire concurrently on 01st October, 2015.

4. Authorization is a statutory process under the *Independent Consumer and Competition Commission Act 2002* ("ICCC Act"). It allows a person or company to gain legal protection under the ICCC Act, to engage in a restrictive trade practice that would otherwise raise competition concerns. Authorization, if granted, protects ANL and Qantas from potential legal action against them for a breach of the ICCC Act as a result of the code-share agreement. The ICCC may grant authorization for ANL to continue the code-sharing arrangement with Qantas*, if it is broadly satisfied that the public benefits which accrue from the code-share agreement will result, or will be likely to result, in a greater benefit to the community*. The onus is on the parties to satisfy this requirement.

5. While there are some competition concerns, the ICCC is generally of the view that the continuation of the code-share agreement will result in a greater benefit to the travelling public and the community at large.

6. The ICCC, in its consideration of the application, noted certain detriments likely to result include, but are not limited to -

   a. reduction in the number of potential independent operating carriers on the code-share routes; and

   b. Continuous poor financial performance of ANL on the code-share routes.

7. On the other hand, the ICCC's assessment shows that the code-share services would potentially result in greater benefits to the general public in the following ways:

   a) maintaining competition in prices in the PNG/Australia air services market as far as passenger and freight services are concerned;

   b) maintain lower prices for freight and passenger services;

c) increased flight options and frequencies that increase travellers' choice of travel time and dates;

d) direct flights from Port Moresby to Sydney;

e) on-ward route connections for travellers from Australia through to other destinations, using Qantas' established networks; and

f) maintaining jobs for employees, as ANL is one of the large employers of nationals in PNG.

8. On balance, the ICCC is of the view that the code-share would result in greater benefits to the community.

9. To minimise some potential detriments to the general public, including competition concerns, the ICCC considers it necessary to impose some suitable conditions. The conditions are as follows:

a) that, for passenger services for the Port Moresby-Brisbane route and the Port Moresby-Sydney route, ANL and Qantas comply with Annexure 1, the revised seat block;

b) that, for freight services for the Port Moresby-Brisbane route, the marketing carrier be allowed to take not more than 40% (forty percent) of the total proportion of overall aircraft capacity for freight for every flight, in each direction, on every day of the week, throughout the year, for the duration of this authorisation;

c) for the purposes of monitoring conditions a) and b) above, the code-share partners provide to the ICCC six (6) monthly yield and load factor reports, for both passenger and freight, for the duration of this authorisation;

d) that, the Sydney leg is not authorised for freight services. Any future proposal to introduce freight code-sharing on that route would need to form the subject of a separate application at the relevant time;

e) that, subject to condition f) below, if either party enters the PNG-Australia air freight market, as a regular cargo carrier, in its own right and outside the code-share agreement authorised by the ICCC, apart from existing passenger-cum-freight services on the Port Moresby-Cairns route and the Port Moresby-Sydney route, without an amendment to the code-sharing arrangement that reflects such entry and which is authorised by the ICCC prior to such entry, the freight component of this authorisation will cease forthwith;

f) that, if a code-share partner wishes to provide irregular services outside of the code-share agreement to carry *specific type of freight* which may not be suitable to carry on the code-shared aircraft, the code-share party intending to provide that service must give two (2) weeks prior notice informing the ICCC the type of cargo the carrier will carry and justify why independent service was necessary;

g) that, the parties must not collude on end-prices to be charged to customers under the code-share arrangements, nor on the capacity or frequency of services not covered by the code-share arrangements; and

h) that, ANL provides six monthly financial statements for each of the code-share routes to the ICCC.

10. **The ICCC may review the operations of this authorisation under Section 80 of the ICCC Act in the event any of the above conditions were not complied with.**

Contents

2. INTRODUCTION

1. This Determination is in response to the application by Air Niugini Limited ("ANL" or "Applicant") to the Independent Consumer and Competition Commission ("ICCC") for authorisation. This application for authorisation (the application) is for the renewal of the current authorisations which the ICCC granted for passenger and freight code-share services between ANL and Qantas Airways Limited.

2. ANL and Qantas began this code-share agreement since 2002. ANL has since been applying for re-authorisation from the ICCC. This application is for another renewal of the current authorisations which the ICCC granted separately for passenger and freight code-share, but were to expire concurrently on 01st October, 2015.

3. The code-share agreement was authorized to cover Port Moresby/Brisbane ("POM/BNE") and Port Moresby/Sydney ("POM/SYD") routes on flights operated by ANL. On the POM/BNE leg, the parties provide both passenger and freight services while the POM/SYD route only covers passenger services using narrow body aircraft. The requirement of using narrow body aircraft on POM/SYD sector was to avoid ANL's loss making on that route. This application for re-authorisation was made jointly for both passenger and freight services.

4. Authorisation is a statutory process and the ICCC is required to review it in a transparent and public manner and make a determination. In this regard the ICCC consulted widely and sought comments and submissions from persons who may have an interest in the aviation industry. All relevant parts of stakeholders' comments and submissions will be taken into account in this Determination. Non-confidential copies of the Applicant's submission, submissions and comments from other stakeholders and this Determination have been placed on the ICCC's Public Register for public inspection. Copies may also be obtained from the ICCC's website at www.iccc.gov.pg.

5. While the ICCC was assessing this application, ANL requested a variation to the currency of the existing authorisations. The details of the variation are discussed below.

6. The purpose of the time extension was also to allow ANL and Qantas sufficient time to renegotiate on the passenger seat block allocation to the marketing carrier because Qantas expressed concerns on the conditions on block range in the existing authorisation. The ICCC requested the parties to renegotiate and submit to the ICCC for its consideration and authorisation.

7. Since seat block allocation is central to the code-share arrangement; and essential for the assessment of whether or not the code-share arrangement would be competitive, the ICCC was waiting to see the outcome of the renegotiation and consider it in its Draft Determination. This was received and the Draft Determination was released on 15th February, 2016.

2.1. Variation request

8. ANL requested the ICCC in its letter dated 4th September, 2015, for an extension of the currency of the existing authorisations. ANL made this request under Section 80 of the ICCC Act. ANL did not indicate the time frame of extension it would like to seek from the ICCC.

9. It was apparent to the ICCC and the code-share partners that renegotiations to review the seat block allocated to the marketing carrier would not be concluded prior to the expiry date of the current authorisations. Even if the negotiations were completed prior to the expiry date of the authorisations, the ICCC would not be able to issue a determination on this authorisation application in time, as other statutory processes such as the issuing of a draft determination for public consultation was likely to take the time beyond the expiry date of the existing authorisations. ANL was also concerned that if there were delays in the negotiation and a determination was not made before the expiry date, it would affect the travelling public who may have done advance booking, which was not good for the business and travellers. Therefore, ANL requested for Variation seeking an extension to the expiry dates on current authorisations.

10. To avoid disruptions of services for the traveling public and to allow sufficient time for the ICCC to consider the application for re-authorisation (which was dependent on the conclusion of seat block allocation renegotiation), the ICCC considered it appropriate to grant extension. The ICCC gave its decision on 29th September, 2015, granting extension for three months from 01st October, 2015; or until a determination on this application was made.

3. BACKGROUND

11. The current code-share arrangement is on a 'hard block' basis. As noted above, ANL and Qantas began this code-share agreement since 2002. ANL has since been applying to the ICCC for renewals of authorisation. The current conditional authorisations for passenger and freight were respectively granted on 28th September, 2012, and 28th February, 2014; and were to concurrently expire on 01st October, 2015.

12. Among others, some major conditions the ICCC imposed on the current authorisations are as follows:

- The marketing carrier (Qantas) does not take less than 30% and not more than 50% of the proportion of overall aircraft capacity for passengers in each cabin class on every flight, in each direction, on every day of the week, throughout the year, on which the service operates;

- Freight space allocated to the marketing carrier is less than 50% of the proportion of overall aircraft capacity for freight on every flight, in each direction, on every day of the week, throughout the year, on which the service operates;

- If either party enters the PNG-Australia air freight market, as a cargo carrier, in its own right and outside the code-share agreement authorised by the ICCC, the freight authorisation was to cease forthwith.

3.1. The code-share parties

3.1.1. Air Niugini Limited (ANL)

13. ANL is the largest PNG-domiciled airline, solely owned by the Government of Papua New Guinea ("GoPNG"). Its main business is the provision of domestic and international passenger and freight services. ANL has a large domestic network that covers a large proportion of the geographic area and serves 24 domestic airports and 11 international airports (Manila, Bali, Singapore, Hong Kong, Tokyo, Sydney, Brisbane, Cairns, Honiara, Port Vila and Nadi) [1].

14. ANL also operates subsidiary airline called Link PNG. Link PNG began its operations in 2014, as a domestic airliner, servicing domestic routes in PNG as well as remote locations not previously serviced by ANL. Link PNG operates as a low cost carrier operating mostly Dash-8 aircrafts.

15. ANL, in general, operates two Boeing 767s ("B767"), three Boeing 737's ("B737"),[2] seven Fokker F-100 jets, three Fokker F-70, and ten Dash-8's. Its aviation related businesses include 22 retail sales offices throughout PNG, catering, engineering and maintenance services, tour packaging and accommodation services, and it also operates value added services such as frequent flyer program called 'Destination Loyalty Program'.

3.1.2. Qantas Airways Limited (Qantas)

16. Qantas is the world's second oldest airline incorporated in Australia in 1920. It is Australia's largest domestic and international airline. It was originally owned by the Australian Government but was privatised, first partially and then wholly, some years ago. It is now entirely a private sector company and is listed on the Australian Securities Exchange.

17. The Qantas Group operates more than 6,400 domestic and 920 international flights each week using two complementary airlines: Qantas – a full service airline offering domestic and international services; and Jetstar Airways a subsidiary of Qantas – a low cost carrier offering domestic and international services, formed to compete with discount operators on international and domestic routes. Jetstar predominantly focusses on servicing price sensitive consumers.

[1] Information taken from ANL's website on 14 February, 2016.

[2] ANL operates two types of B737 air craft, a B737-700 and a B737-800. The latter being the larger of the two and is used on the Sydney route. Annexure 1 below which has the Revised Seat Block Allocations, shows the B737-800 as the aircraft type used for the Sydney POM route, however it is coded as 'B738'. This should not be confused as being another aircraft, it is the B737-800

18. Qantas also operates airline related businesses including airport support services, catering, freight operations, loyalty programs, defence support services and engineering.

4. THE APPLICATION

19. On 21st April, 2015, ANL made an application for a new authorisation to apply when the current authorisations expired. ANL sought authorisation for a period of five years until 30th September 2020.

4.1. Summary of ANL's arguments in support of the application

20. Below is the summary of the Applicant's argument in support of its application. Non-confidential version of the full submission is on the ICCC's website.

21. ANL submitted that without this code-share arrangement, the operations of its wide-body aircraft are not financially viable. While wide-body aircraft are efficient carrying wide range of freight including containerised and/or palletised and large and heavy cargo, this also means that more passengers have to be carried for the aircraft to be economically viable. ANL claimed that it would be difficult for it to sustain wide-body aircraft operations without the code-share.

22. ANL also stated that the PNG–Australian route is thin and it has been unable to achieve sufficient loads on its own on this route to make wide body operations financially viable. ANL also states that the operation of the wide body aircraft without the code-share arrangement is unsustainable. Considering that many sectors in PNG rely on air freight, it is crucial for ANL to sustain wide-body aircraft operations.

23. Considering the above, ANL stated that the code-share agreement sustains the wide-body aircraft operations.

24. ANL states that if authorisation is granted -

a) Both Qantas and ANL will continue to be able to offer consumers high quality, high frequency jet passenger services between Australia and PNG;

b) It will facilitate the continued operation of the wide body aircraft by ANL which provides frequent containerised air freight services between Australia and PNG;

c) Qantas and ANL will continue the two nonstop services per week between Sydney and Port Moresby operated by B737 aircraft which they have introduced;

d) Qantas and ANL will continue to compete in relation to both the prices and terms they offer on both passenger and freight services between Australia and Papua New Guinea; and

e) ANL will continue to be able to offer air freight services between PNG and countries such as Japan, Singapore, Hong Kong, and the Philippines.

25. However, if authorisation is not granted, ANL states the following consequences are likely:

a) ANL will cease the code-share arrangement with Qantas and consequently the code-share routes;

b) ANL submitted that there is a possibility that Qantas may withdraw all air passenger services between Australia and PNG. If this were to occur, the result would clearly be a lessening of competition resulting from the loss of Qantas marketing presence in the Australian Air Passenger Market. It is also expected that Qantas would not introduce a Port Moresby/Sydney nonstop service due to lack of sufficient volume for an independent operator. The Brisbane services might be operated by Qantas or its subsidiary, Jetstar;

c) As with ANL, it submitted that without the support from a code-share partner, demand from PNG/Australia market is not sufficient to support high frequency wide-body air services; and Qantas would therefore be most likely to offer a more frequent service using a narrow-body aircraft which may not be able to support the freight services;

d) ANL is of the view that Qantas would introduce at least 6 Boeing 737-800 services per week operating between Brisbane and Port Moresby due to the fact substantial capacity will be available to the market than that currently available to Qantas under the code-share. A total capacity of over 52, 416 extra seats would be available to Qantas per annum in each direction on a route that has a current operated capacity of 120, 536 seats per annum;[3]

e) It would not be viable for ANL to continue direct flights between Port Moresby and Sydney without the code-share as there is insufficient demand on that route to maintain an independent operation;

f) ANL may cease to operate Sydney route, and instead only service the Brisbane route independently using narrow body aircraft as it would not be economically viable to operate wide body aircraft;

g) ANL would then replace its B767 with a narrow-body aircraft to service its international destinations. The restructuring to narrow-body aircraft would also affect ANL's passenger services to Asian destinations as its current use of the wide-body aircraft enables ANL to offer competitive connections to Australia and the Pacific;

[3] ANL Authorisation Application 2015/*page 17*

h) Freight services may not be available due to the withdrawal of operations of wide body aircraft; hence PNG may be forced to rely on dedicated freighters which are costly to operate and customers may pay higher freight charges. The frequency of services may be lower than currently provided by ANL and Qantas through the code-share arrangement; and

i) Qantas may take the opportunity to be the primary freight provider, using its wide-body aircraft for one or more of its PNG services.

5. SUBMISSIONS BY STAKEHOLDERS

5.1. Submissions before the release of Draft Determination

26. The ICCC thanks all the stakeholders who have participated in the public consultation process in providing their submissions and comments, both before and after the issue of the Draft Determination. Only relevant parts of the submissions and comments have been considered in assessing this application. Summaries of relevant parts of the submissions and comments received are set out below.

5.1.1. Hevilift

27. Hevilift does not oppose the application and states that it took no exception to ANL's application to continue with its code-share agreement with Qantas.

5.1.2. Civil Aviation Safety Authority

28. Civil Aviation Safety Authority ("CASA") briefly stated that it supported ANL's application on the basis that the arrangement will result in a net benefit to the public, provided efficiencies and cost savings are realized and the route is, in the long run, sustainable.

5.1.3. Department of Infrastructure and Regional Development of Australia

29. Providing a submission on behalf of the Australian Government, the Department of Infrastructure and Regional Development (DIRD) does not oppose the authorisation and remains consistent with previous views to support the code-share arrangement. DIRD stated that the Australian Government's policy is to pursue an open freight and code-share arrangement as possible so as to provide airlines with the commercial freedom to quickly respond to market demands.

30. DIRD submits that blocked space code-share arrangements between airlines add an element of competition to a market that might not otherwise be possible if only a single airline was to market services on the route. While noting the proposal to extend the authorisation to a five year term, DIRD also summits that the Australian Government would not expect any adverse effect to competition in the bilateral market as a result of any re-authorisation.

5.1.4. Investment Promotion Authority

31. The Investment Promotion Authority (IPA) supports re-authorisation and commented that it has no issues with the renewal.

5.1.5. Department of Transport

32. In supporting re-authorisation to ensure continuity of the code-share arrangement between ANL and Qantas on the PNG/Australia routes, the Department of Transport (DoT) submits that the sustainability of operations on the two routes is dependent on the continued code-share arrangements between the two airlines sharing resources resulting in benefits to the public outweighing the lessening of competition. The thin traffic on the route does not warrant each airline launching its own services on the routes.

33. DoT further stated that the code-share arrangement augurs well with current Government policy in fostering cooperative arrangements between designated airlines under the various bilateral ASAs. ANL and any other PNG designated airline will benefit from such arrangements utilizing the bigger extensive market networks of bigger airlines in the region.

5.1.6. Qantas

34. Qantas highlights some public benefits that the code-share had delivered and supports the application for re-authorisation. Some public benefit arguments of Qantas in support of a renewal of the current authorisation were: (1) supporting development of important international trade and tourism links between PNG and Australia; (2) improvement of travel and freight options available to consumers, whilst at the same time; (3) maintaining competition between the two airlines.

35. However, Qantas expressed that the conditions imposed on the current authorisation created a model which was not sustainable going forward and was not balanced and did not reflect the characteristics of the passenger and freight markets and that the conditions had distorted the operating environment.

36. Qantas indicated that in the event the passenger or freight code-share arrangements were not re-authorised, or, were re-authorised with unviable conditions, Qantas would have to reassess its customer proposition and commercial position in the PNG market. Qantas stated that in no other market was Qantas subjected to the degree of regulatory intervention imposed by PNG in circumstances where there is no suggestion of any consumer detriment.

Passenger code-share services

37. Qantas expressed that it is forced to code-share on all services at levels which do not always reflect peaks and troughs of demand in the market. This

increases Qantas's costs and is not commercially optimal, nor is it considered by Qantas to be sustainable. Further, Qantas did not agree with the conditions and believed that *"... commercial terms should be agreed between airlines without regulatory intervention"*.[4] Qantas also contested that the quantum of capacity should be freely determined between the airlines in accordance with the dynamics of the market.

Freight code-share services

38. Qantas claimed that the freight market between Australia and PNG is volatile and, overall, is typically one directional with significantly higher volumes being carried northbound into PNG. Qantas argued that such characteristics of the market warrant soft block arrangements, or at least a combination of both hard and soft block components.

39. Qantas also expressed concerns with the condition on the current freight authorisation to terminate the authorisation if Qantas operates a separate dedicated freighter on the PNG/Australia route. They mentioned that the provision of dedicated freight services is provided for under the bilateral ASA between PNG and Australia. Qantas was concerned that ICCC has imposed such a restriction on Qantas as such services would benefit the PNG economy.

40. Qantas further claimed that the demand for dedicated freight and charter services between PNG and Australia is highly dependent on and driven by activity in PNG's resource sector. The type of freight articles transported by dedicated freight services often require specific uplift capability and are not suitable to be carried as belly hold freight.

5.1.7. Independent Public Business Corporation

41. IBPC, now Kumul Consolidated Holdings ("KCH"), supports re-authorisation stating that there is no lessening of competition under the current code-share arrangements due to each airline continuing to market and price their seats independently. KHC also stated that there is on-going competition from Virgin.

42. KCH supports ANL and further stated that the arrangement allows ANL to operate wide-bodied aircraft.

5.1.8. Department of Commerce, Trade and Industry

43. The Department of Commerce, Trade and Industry ("DCI") stated that the code-share agreement has an immediate effect on reducing the number of potential operating carriers; in this case, ANL. The service offered by one operating carrier along the service chain may be inefficient or inferior in quality than what would otherwise prevail if the parties were to operate independently. For this reason, the DCI submitted that ICCC may consider entering into a service standard agreement with ANL outlining service standards and simply consider this as part of the conditions of the

[4] Qantas' letter dated 17th June, 2015, p.3

authorisation for the code-share agreement if the ICCC decides to grant authorisation.

44. In terms of airfares, the DCI submitted that the participating airlines must maintain independence in the pricing of the seats consistent with the competition/anti-trust laws. In the block space code-share, Qantas may purchase fixed number of seats from ANL at a discounted price. Qantas may then sell the seats independently from ANL and this may result in efficient pricing provided ICCC imposes restraint on the insertion of ceiling or floor resale price maintenance clauses. The DCI stated that ICCC should encourage the adoption of the block space in any code-share agreement including the one in consideration with the no 'floor or ceiling resale price maintenance' condition.

45. The DCI further stated that any efficiency in the pricing by Qantas under the block space code-share may significantly benefit the incoming passengers like tourists and business travellers originating from Australia, which may seem counterintuitive to the overall intent of the ICCC Act, which is to ensure that there is a net benefit to PNG consumers before granting an authorisation for a restrictive trade practice. Where a significant number of seats are purchased and resold at lower prices by Qantas under the block space code-share, ANL may be under competitive pressure to sell the residual seats on par or below Qantas'. When this eventuates, the PNG consumers stand to benefit from the reduced fares.

46. The DCI concludes that a code-share is necessary subject to block space code-share to maintain the competitive market features, or if not some competitive market attributes.

5.2. Submissions on the Draft Determination

5.2.1. CASA

47. In its comments on the Draft Determination, CASA stated that it supported ICCC's proposed determination.

5.2.2. IPA

48. In its submission on the Draft Determination, IPA reiterates its support for reauthorisation and further stated that there should be a little flexibility in any urgent cases to amendment conditions that may cause inconvenience to ANL operations.

5.2.3. Qantas

49. Qantas, in its submission on the Draft Determination, expressed disappointment that the Draft Determination proposes to uphold restrictions on the arrangements through conditions. According to Qantas, the conditions proposed in the Draft Determination do not adequately reflect the unique

characteristics of the passenger and freight markets between Australia and PNG.

50. Qantas further submitted that it does not consider it necessary for the additional revenue and yield monthly reporting however suggested that providing monthly seat and load factor reports for the passenger and freight code-share would be more appropriate to understand route performance.

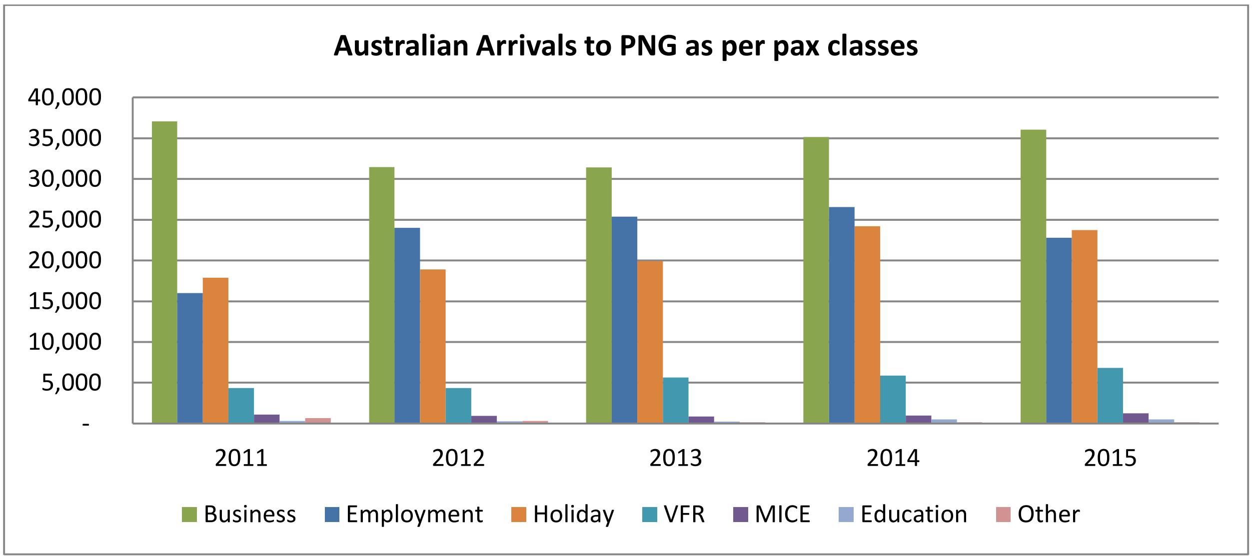
51. Qantas concluded that it maintains that its preferred outcome is to see reauthorisation of the code-share without commercially restrictive conditions.

5.2.4. Papua New Guinea Tourism Promotion Authority

52. The Papua New Guinea Tourism Promotion Authority ("PNGTPA") supported the application made by ANL for the renewal of authorisation for both passenger and freight services in accordance with the existing code-share agreement.

53. PNGTPA submitted that Australia is an important source market which contributes about 50% of total tourism arrivals into PNG. The traffic from Australia remains one of the important markets for growth in PNG tourism. Australian arrivals figures supplied by PNGTPA generally showed an increase in the Australian arrivals to PNG since 2011. Despite a slight drop in 2015 due to the cancellation of 'visa on arrival policy', PNG would continue to benefit from the strong growth in Australia's outbound travel.

Figure 1. Australian arrivals into PNG from 2011 to 2015.



Source: PNGTPA submission on Draft Determination

54. PNGTPA also indicated that the tourism industry of PNG embraces the competition set by the aviation industry in PNG and supports the benefits outlined in the Draft Determination.

55. PNGTPA further stated that if Qantas withdrew all air travel services between Australia and PNG, there would be no competition as without the support from a code-share partner, demand from PNG or Australia will not be sufficient. Regarding Qantas' comments on the imposed conditions on the current authorisation, PNGTPA understands that both code-share parties' arguments are based on importance to generate business. PNGTPA understands that all sectors including tourism is greatly dependent on the direct flight services for ease of travel by tourists as well as business travellers and urge both code-share parties to weigh out all options.

56. In conclusion, PNGTPA believes there should be a renewal of the current authorisations to continue code-sharing services. PNGTPA also indicated that since tourism is expected to add traffic volumes to the current capacity due to reasons like the Tourism Hub concept, hence a greater need to maintain current flight to and from Port Moresby, Brisbane and Sydney.

6. ICCC EVALUATION

6.1. Competition assessment

6.1.1. Relevant market

57. Section 45 (2) of the ICCC Act, the term 'market' is defined as;

"….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".

58. Since there has not been material difference in the terms of the code-share agreement and the type of services the parties would provide, and that the Applicant's definition of the market is consistent with ICCC's definition in previous Determinations of similar applications, the ICCC agrees with the Applicant's definition of the relevant markets. The relevant services are the air passenger services market and the airfreight services; hence the relevant markets are -

a) *Provision of air passenger and freight services between PNG and Australia (the Australian market); and*

b) *Provision of air passenger and freight services between PNG and each of the other international destinations currently serviced by ANL's B767 aircraft (together, the Asian markets).*

6.1.2. Passenger and freight movements

59. Australia/PNG route is currently recognised as a 'thin' route[5]. The traffic volume is not sufficient to attract new entrants or expansion of the

[5] Determination A2012/15 – APNG/Virgin Australia Code-share Authorisation Application, pp.17

incumbents. Airlines of PNG, now PNG Air, who withdrew its Cairns services and subsequently terminated its code-share agreement with Virgin Australia (Virgin) on the POM/BNE route in 2013, is a possible explanation of low traffic volume between PNG and Australia.

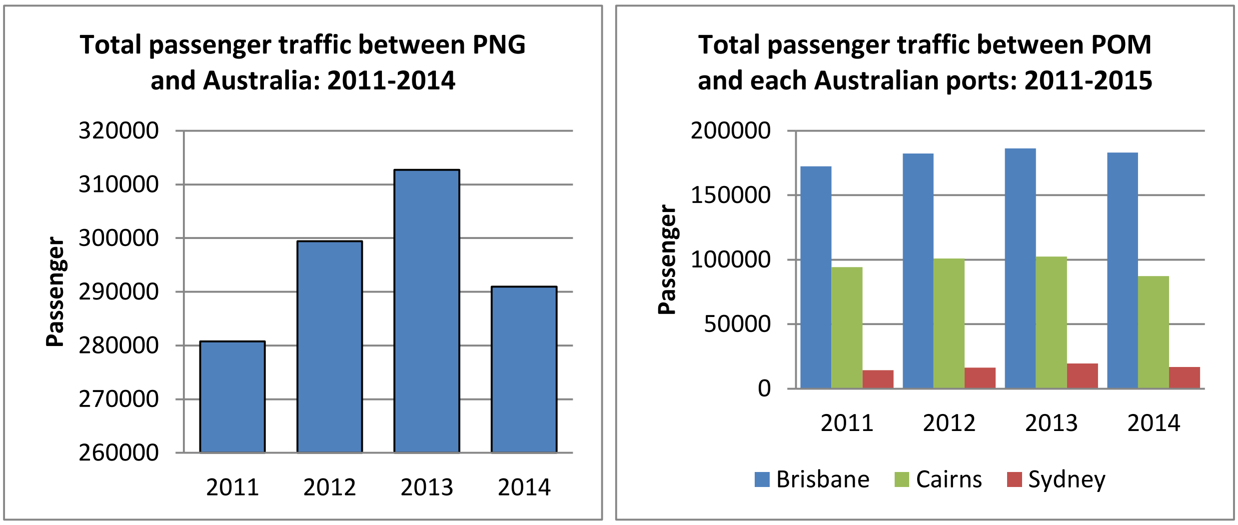
60. For both passenger and freight movement, it is noted that generally, both tend to follow a similar pattern. They increase and decrease at around the same time. According to the Applicant, the fall was due to softening of the market after the completion of the construction phase of the PNG LNG project[6].

61. With the new projects such as Papua LNG, P'nyang Gas, Stanley Gas, Solwara 1 and other bigger projects coming on stream in 2017 and onwards, the ICCC anticipates that the volume of traffic would increase.

Passenger

62. The data of total passenger movement between PNG and Australia obtained from the Bureau of Infrastructure, Transport and Regional Economics (BITRE) for 2011 to 2014 has represented a 6.6% increase in 2012 and a further increase of 4.4% in 2013; however decreased in 2014 by 7%.

Figure 2: Total passenger movement between PNG and Australia



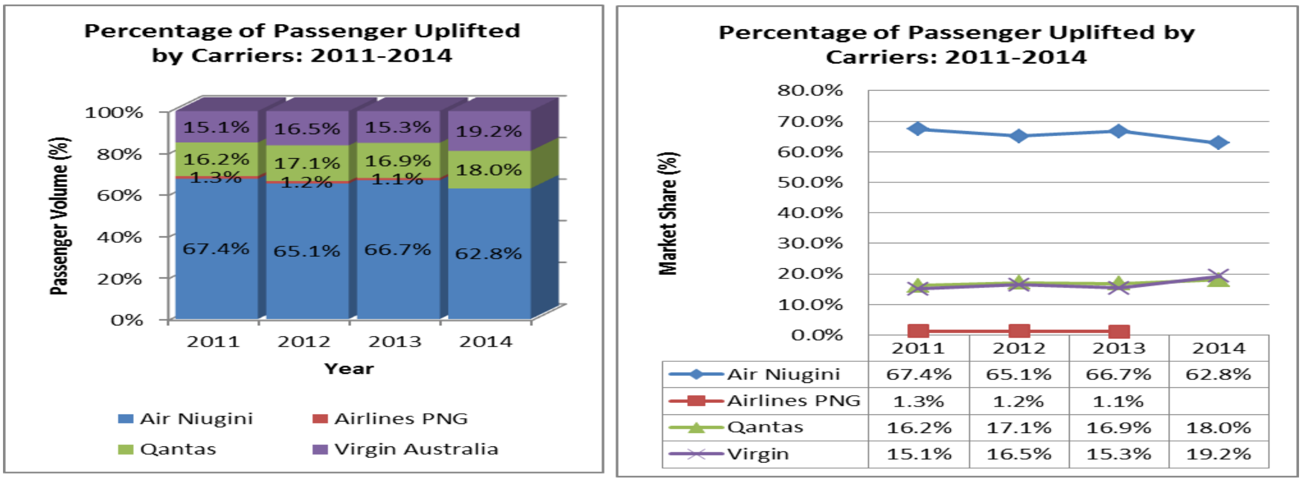
Source: BITRE of Australia

63. The Brisbane sector still records the highest movement of passengers between PNG and Australia followed by Cairns and then Sydney.

64. When considering traffic carried by each carrier, the combined volume of ANL and Qantas has been fluctuating since 2011.

[6] ANL Authorisation application dated 27th April, 2015, page 23

Figure 3: Share of total passenger uplifted by carrier between PNG and market[7]



Source: BITRE of Australia

65. In 2014, while combined volume of ANL/Qantas fell, Virgin's volume increased. This is also true for the POM/BNE route as shown in the first diagram of Figure 2 above. From confidential information submitted by ANL, it was noted that the code-share partners have been competing for market share on the POM/SYD sector. The ICCC notes that hard block allocation and appropriate authorisation conditions have increased the level of competition between the code-share partners on this sector.

66. Comparing the last nine years until 2014, ANL's traffic volume has slightly decreased, especially for the Brisbane route. This indicates that Qantas and Virgin have won more market share on that route, suggesting a presence of competition.

Freight

67. The size of the freight market between PNG and Australia is very small in terms of volume. The directional movement is not balanced in that the bigger portion of the volume is north-bound rather than south-bound. This also contributes to the lower volume of cargo traffic on the Australian market. Hence, there are few air cargo carriers operating between PNG and Australia. It should also be noted that in terms of total volume of freight movement between PNG and Australia, while Sydney and Cairns routes are not code-share routes, they also contribute to the total amount.

[7] It should be noted that Virgin's market share includes that of PNG Air as a result of their code-share arrangement on the Brisbane sector until 2013 when their code-share was terminated. Virgin's market share of much of 2013 to 2014 is its individual share for the Brisbane route.

PNG Air's passenger share indicates the passenger movement on the Cairns route until 2013 when its international service was withdrawn to focus on domestic market.

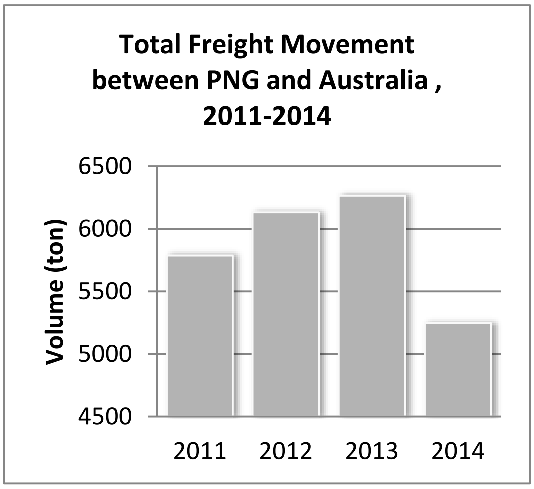
ANL's passenger share is the total passenger it carried between PNG and Australia (for the code-share services and its independent services on the Cairns route). Thus ANL's total passenger volume also includes that of Qantas'. Qantas' share shown in the graphs are only for the passenger uplifted on the Cairns route.

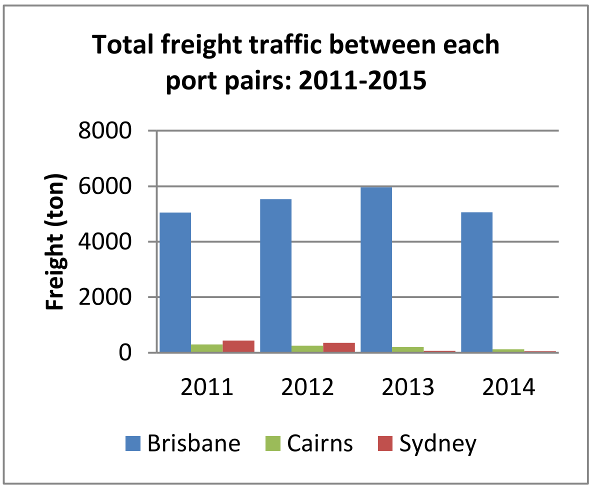
68. With Government policies such as import ban on certain vegetables (which the Government has temporarily lifted at the time this Determination was being issued, to address supply shortages), the airfreight volume is expected to decrease and contribute to low airfreight volume between PNG and Australia.

69. However, with more LNG project prospects on the way, like the Papua LNG, P'ynyang gas and Stanley gas, an increasing trend in airfreight traffic is to be expected in the near future.

70. Generally, for the freight market, total volume of cargo uplifted from 2011 to 2014 showed increases, indicating that the market is growing. The ICCC notes from data from BITRE that there was a big drop in 2014 due to the fact that PNG Air and Qantas ceased freight market operations and the end of the construction stage of the PNG LNG affecting freight traffic. The total freight carried between PNG and Australia increased by 6% from 2011 to 2012 and also increased by 2.2% in 2013.

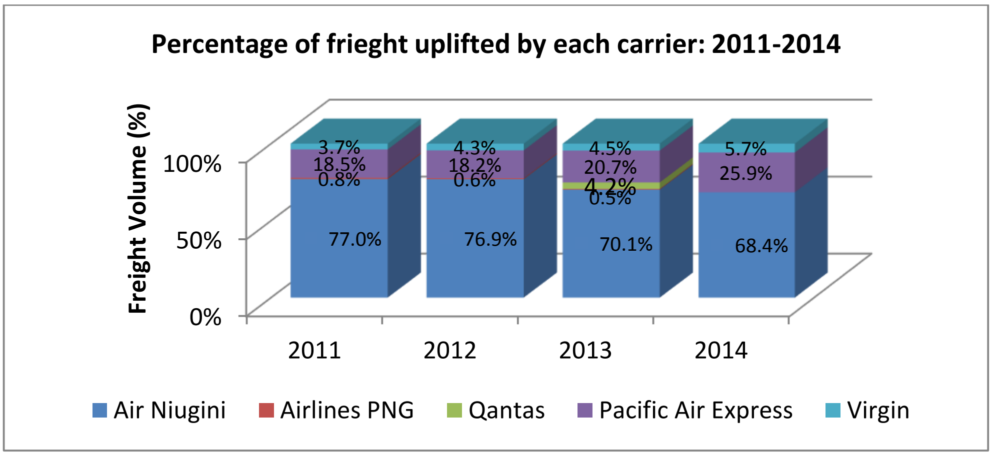
Figure 4: Total freight movement between PNG and Australia





Source: BITRE of Australia

Figure 5: Annual freight movement uplifted by carriers



Source: BITRE of Australia

71. The graph above clearly shows that the total volume uplifted by ANL/Qantas alliance has been gradually declining while Virgin and Pacific Air Express ("PAE") have seen some corresponding increases, although there was minor decrease for PAE in 2012. Although the ANL/Qantas alliance's total cargo volume has been declining, the decreases are not substantial, in percentage terms. The ANL/Qantas alliance still dominates both passenger and freight markets.

72. In 2013, Qantas briefly entered the freight market in July, and terminated its services indefinitely in mid-October of the same year. Figure 5 above clearly shows the share of Qantas as a result of this entry.

73. The ICCC had competition concerns regarding Qantas' independent operations besides the existing code-share services. Its concerns were expressed in the freight authorisation Determination of 2013[8]. The ICCC stated that,

"That development needs to be considered in the public benefit and competition context. The action by Qantas to independently operate freight services on the route posed some important considerations to which the Commission (ICCC) has been giving consideration. While there is no indication that Qantas recommenced its dedicated freighter service as it was suspended indefinitely, it indicates the possibility that it could re-enter and, in that scenario, the two largest players in the market with an overwhelming combined market share could collaborate to influence the freight rates. In normal competition analysis, this situation would have resulted in a conclusion of a substantial lessening of competition, due to the very high level of concentration and high barriers to entry creating powerful incentives for the two carriers to engage in tacit collusion. If Qantas decides to re- introduce the freighter service, the public benefit arguably may not be sufficient to outweigh the anti-competitive effect. In those circumstances absent the code-share, the parties would compete vigorously for freight and the benefits from competition could outweigh the rationalisation benefits. It is appropriate, therefore, for the Commission to consider the possibility of re-entry by Qantas during the term of this arrangement. In such a situation, the public benefit and anti-competitive effects of the code-share arrangement would need to be re-assessed."

74. When issuing that Determination, the ICCC considered that it was necessary to impose a condition *"… that if Qantas re-enters the freight market in its own right as a carrier then this authorisation will cease forthwith."*[9]

75. For this application, while the ICCC considers that it is appropriate to maintain a similar position, it also has regard to situations where specific type of freight which may not be possible to be carried on the code-shared aircraft. The ICCC will impose appropriate condition(s) to address this.

6.1.3. Structure of the code-share agreement

76. The ICCC maintains the view that the impact of code-sharing on competition will depend very much on the extent to which the code-share partners compete with each other. Thus the structure of the code-share agreement should be

[8] ICCC Determination A2013/16 – ANL and Qantas Freight Code-share Authorisation, pp. 22-23.
[9] Ibid.

designed in the manner that stimulates competition between the code-share partners.

77. In its 2009 Determination, the ICCC noted that the block arrangement at that time inherently favoured Qantas relative to ANL[10]. Thus ANL was placed under more pressure to price competitively to sell its seats than Qantas, particularly on days of low demand where Qantas purchased smaller proportion of the seats on the aircraft[11].

78. In the 2012 application for re-authorisation, the ICCC noted that similar arrangement remained as ANL was left to carry the 'high risk' proportion on low traffic days and directions. While there was a sharing of seats, there was asymmetry of risk, against the operating carrier and in favour of the marketing carrier.[12]

79. While the ICCC acknowledges that the 'all-hard-block-capacity-allocation' arrangement was more competitive than other types of code-sharing arrangements, to encourage vigorous competition between the code-share partners and to minimise the potential public detriments resulting from ANL's loss making on the code-share routes (which is discussed in detail in latter part of this Determination), the ICCC prefers that the allocation of the hard block seats to Qantas were larger and uniformly spread across different days of the week.

80. To address the issue of uniformity across different days and flight directions, and sharing risks among the code-share partners, the ICCC fixed upper and lower limits for passenger services. The ICCC determined that Qantas should not exceed 50% of the overall freight capacity of the aircraft on all flights. For the passenger services, ICCC also imposed a condition where Qantas should not take more than 50% and less than 30% of the overall passenger capacity of the aircraft on each flight between the code-share routes. According to ANL, such conditions provide an incentive for vigorous competition between the code-share parties.

81. The ICCC notes Qantas concerns on the type of authorisation conditions imposed. Qantas stated that such conditions were unnecessary and commercially restrictive. The ICCC took those concerns into consideration and have asked the code-share partners to renegotiate the passenger seat block allocated to Qantas. The final block allocated to Qantas[13] was provided to the ICCC which the ICCC proposed to authorise the revised seat block allocation. On the space allocation for freight, the ICCC notes from ANL's submission that the parties have revised the block arrangement for Qantas to purchase up to 40% of the total freight capacity of the aircraft to be used for freight services. The ICCC accepts that and will consider it in this Determination.

[10] 2009 Authorisation Determination, ANL/Qantas Code-share Agreement, pp. 30.
[11] Ibid.
[12] 2012 Authorisation Determination, pp.52.
[13] Annexure 1 to this Determination

82. As mentioned in paragraph 75 above, the ICCC acknowledges that there may be certain situation where one of the code-share partners would like to provide freight services outside of code-share for specific type of freight that may not be suitable to be carried on the code-shared aircraft. With certain large resource projects in the extractive industries coming on stream, there may be demand for airfreighting large equipment from Australia which a code-share partner may wish to provide that service on an *ad hoc* basis. The ICCC recognises that and will impose appropriate condition(s) to address this. Such allowance will not apply to freight that can be carried on the code-shared aircraft.

83. While the ICCC accepts the changes in the seat and space block allocated to the marketing carrier, with the interest to encourage competition between the codeshare partners, increase potential consumer benefits in terms of lower fares and to minimise the losses ANL has been incurring on the code-share routes, the ICCC considers it appropriate to maintain the 'maximum and minimum range' conditions. As mentioned above, such a position was initially taken in the 2012 Determination to *"… prevent 'cherry picking' which benefits the marketing carrier at the expense of the operating carrier, which ultimately prejudices the citizens of PNG. In such circumstances, if one of the parties considers the arrangement unacceptable, it has the option of abandoning the proposal if they consider the conditions too onerous."*[14] The essence and context of Commission's discussions on this type of conditions in the 2012 Determination still applies here as this application is for re-authorisation of the existing authorisation.

84. While Qantas expressed disappointment of certain Authorisation conditions that the ICCC did not take into consideration the unique characteristics of the PNG/Australia market when imposing such conditions, the ICCC notes that ANL did not make similar comments in its submissions. However, ANL stated on page 5 of its submission that the current code-share under hard block arrangement is very competitive. Below is what ANL stated:

"… the code-share arrangements between Air Niugini (ANL) and Qantas, under BLOCK CODE-SHARE 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 code-share 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 centres.

[14] 2012 Authorisation Determination, pp. 52.

This results in a high level of competition between the carriers. Over the period of the code-sharing arrangements between Air Niugini and Qantas, Air Niugini's fares have generally declined in real terms on both the Brisbane route and Sydney route…"

85. Given that PNG/Australia route is a thin route and few carriers are operating the route, the ICCC believes code-share arrangement under hard block basis is the way to go to have vigorous competition in the relevant markets.

86. According to ANL's submission, the ICCC notes that Qantas would be allocated up to 40% capacity of the total freight capacity of an aircraft on the Brisbane route.

87. The proportion of passenger seats allocated to the marketing carrier is annexed to this Determination. From the revised seat block allocation table provided by ANL, the ICCC notes that, generally there has been a reduction in the number of seats allocated to Qantas on every cabin class, on each flight, in each direction, on every day of the week.

88. The ICCC believes that if hard block numbers were to be uniform throughout the year, covering low and high traffic periods for both passenger and cargo, competition between the code-share partners would be enhanced and consequently, increased benefits to travelling public and shareholders.

6.1.4. International designation and capacity allocation

89. The ICCC notes that competition issues identified in previous code-share determinations have not been improved. The ICCC believes that the competition issues exist due to the discriminatory requirement for aircraft availability and discriminatory grant of capacity to one carrier still remains as the agency responsible did not make any submissions, if there were improvements. Given these regulatory circumstances remain the same today, the ICCC considers, from the competitive neutrality perspective that regulatory issues need to be addressed by the appropriate agency to encourage expansion of the existing carriers and lower barriers for potential new entrants.

6.1.5. Barriers to Entry

90. ANL claims that barriers to market entry are low and potential competitors are ready to enter to provide airfreight and/or air passenger services if ANL and Qantas raise airfares or reduce service levels. The Applicant claims that:

a) There are "no regulatory barriers" and there is more than adequate seat and freight capacity available under the ASA between PNG and Australia to allow a new carrier to any or all of the code-share routes and both countries allow multiple carrier designation.

b) There are "no slot constraints" at any of Port Moresby, Cairns, Brisbane or Sydney airports that would be likely to hinder the entry of a new carrier on any of the code-share routes;

c) Ground handling facilities for freight and passenger are readily available at all airports relevant to any of the code-share routes;

d) There is an active international market for the purchase of aircraft by new entrants at competitive prices; and

e) Sunk costs are minimal as aircrafts can be readily resold and if new entrants want to minimise start-up capital requirements, active market exists to enable a new entrant to lease appropriate aircraft with minimal capital outlay.

91. With regards to the claim that there are no regulatory barriers, the ICCC has the opposing view because of the discussions on discriminatory designation and capacity allocation mentioned above; and maintains that there are regulatory barriers to entry. These regulatory issues needed to be addressed by the appropriate agency before such claims as "no regulatory barriers" can be accepted.

92. The ICCC notes that practical barriers like an airline being unable to negotiate landing slots at relevant airports prevent an airline from expanding on the relevant route in the short-run[15]. The ICCC understands that generally, relevant airports are not currently slot constrained so this is unlikely to be a longer term barrier to entry. With Jackson's Airport recently being announced for upgrading, slots are expected to increase and airlines can negotiate with relevant authorities for slots. Also, ground handling facilities pose no barrier as the relevant airports are accessible and readily available.

93. With regards to sunk costs and aircraft lease, as noted in its previous determinations[16], the ICCC considers that there are significant sunk costs associated with setting up lease arrangements, marketing costs, technical and financial borrowing arrangements and financial guarantees. This is a barrier to entry, especially to potential entrants.

94. Also, as mentioned in the previous determination, considerations of economies of scale and scope and network economies as barriers to entry is important in the industry where concentration level is high. While acknowledging ANL's continued investment in bigger and more efficient aircraft with larger belly-hold capacity to carry freight and passenger and freight, the ICCC considers that such business acumen can be anti-competitive if it has the effect of disadvantaging other players and potential entrants from entering and/or competing effectively. This can be considered as a barrier to entry and expansion. The exercise of business acumen is pro-competitive and not anti-competitive; however, incumbents enjoying such advantages should not be given additional market advantage such as being permitted to collaborate in circumstances where concentration is high[17].

[15] Determination on airline alliance between Virgin and Air New Zealand, p78
[16] ICCC Determination A2012/13, p33
[17] ICCC Determination A2012/13, p32

6.2. Assessment of public benefit claims

95. In supporting its application, ANL claimed that the following public benefits or benefits to the community are likely to result, if authorisation is granted. The likely benefits as claimed by ANL are –

1. that the code-share maintains competition in the Australian market,
2. avoidance of potential losses in revenue to PNG Government from the code-share,
3. benefits to the PNG economy and the balance of payment,
4. air freight,
5. improvement to services and customer choice,
6. efficiencies,
7. likely effect on employment, and
8. national flag carrier.

96. At the outset, the ICCC does not necessarily accept such claims entirely. Public benefit claims by the applicants and any other claims by any interested parties, if any, will be tested against the general test for authorisation.

97. The ICCC notes that all these public benefit claims are essentially the same as those claimed in the previous application. The ICCC has discussed each of them in detail in its 2012 Determination. Given that there are no substantial changes in the code-share arrangement apart from the reallocation of seats to the marketing carrier, the position the ICCC took in the 2012 authorisation will remain the same.

6.2.1. Competition in the Australian passenger market

98. ANL claimed that the Brisbane and Sydney routes are currently serviced by two operating carriers, ANL (both Sydney and Brisbane), and Virgin (Brisbane). ANL stated that after the restructure that would follow the loss of the current code-share arrangements due to non-authorisation, it is likely that the number of operating carriers on these routes would remain at two (i.e. ANL and Virgin), however neither carrier would operate a wide-body aircraft, and neither is likely to offer direct services between Port Moresby and Sydney. Moreover, immediately the competition from Qantas on the respective routes will be lost; and, ultimately there will be a less competitive market structure than the market with authorization.

99. As mentioned above, the ICCC notes that the Australian market is a 'thin' route in terms of traffic volume. While recognising the possibility of Qantas' withdrawal if authorisation is not granted, the ICCC is of the view that Qantas is likely to operate independently on the Brisbane route as it commands the patronage of the northbound passengers and continues to enjoy high business revenue yields on the route. Hence the loss of a competitor and operator may not be permanent. However, if Qantas' decides <u>not</u> to operate independently on the route, that would mean the potential loss of a competitor and consequential negative impacts like price increases would be possible.

100. The ICCC also considers that increased competition on this route, if that results from denial of authorisation, will result in ANL gradually withdrawing its B767 wide-body services and introduce narrow-body aircraft as there would not be sufficient passenger volume to fill all the seats in the wide-body aircraft. This would have negative consequences for travellers and businesses in PNG who dependent on the wide-body aircraft for exports and imports.[18]

101. The ICCC also considers that without the code-share, there will be an immediate loss of a marketing carrier and competitor on the Sydney route. ANL may benefit in getting the entire passenger volume but it would have detrimental effects on travellers such as increased air fares, decrease in flight frequencies which may lower choice for travelling days.

102. As shown in Figure 2, unlike Brisbane and Cairns, the passenger volume on the Sydney leg is very minimal to attract independent operation or an entry by another airline.

103. Therefore, the ICCC is of the view that the code-share is vital to maintain the current level of competition between the code-share partners on both Brisbane and Sydney routes until such time Qantas decides to operate independently. On the Brisbane route, importers and exporters would benefit in terms of the movement of their freight.

6.2.2. Avoidance of potential losses in revenue to PNG Government

104. The ICCC notes that the arguments here are the same as that put forward in its previous applications which a detailed assessment and analysis was done in the 2012 Determination; and it does not wish to discuss them further here. Hence, the ICCC maintains the position it took in the 2012 authorisation.

105. The ICCC maintains that ANL's claim of this public benefit must be taken in light of its financial history since the code-share with Qantas began in 2002. ANL has not had a great history of being a strong revenue earner for the Government *through* this code-share; hence the 'additional losses to the PNG Government' should the code-share be denied may be very minimal. Thus, it does not add weight to this public benefit claim. However, to minimise losses and to ensure that there is a continual stream of revenue for ANL regardless of peaks or troughs in the market, the current authorisations were granted with the conditions. This was to ensure that ANL's financial position was strong. Hence, the ICCC imposed some conditions in its current authorisations on the range of passenger and freight capacity to be allocated to the marketing carrier. This would minimise ANL's potential losses, hence the public detriments; and thus the test for an authorisation can be met and authorisation granted.

106. Without such conditions, there would not be such vigorous competition as has occurred between the code-share partners. Without the conditions also, that continued stream of revenue for ANL and ANL's financial position may

[18] Determination A2012/13 page 34 para 7.7

deteriorate. Hence, the public benefit claims mentioned above may not hold as much weight, which could lead to the authorisation being denied. The ICCC would like to maintain that current structure of the code-share agreement and the types of conditions imposed provide incentives for the code-share partners to be more competitive.

6.2.3. Benefits to PNG Economy and Balance of Payments

107. The ICCC accepts that ANL through the code-share does bring in direct foreign exchange revenue. Indirect foreign exchange revenue is also earned as the code-share routes facilitate trade and tourism links. On the other end, ANL does, however, leak out foreign exchange through the high cost lease payments for aircraft and payments in foreign exchange to overseas service providers. The public benefit claims for foreign exchange earnings have to take these issues into consideration and have to be balanced with foreign exchange payments earnings *through* the code-share arrangement.

108. Given the recent shortage in foreign exchange reserves in the PNG economy and the control measures implemented by the Bank of PNG ("BPNG"), one could argue, taking into consideration the foreign exchange that ANL leaks out through the payments we have discussed above, that the impact of ANL's foreign exchange earnings through this code-share agreement has on the country's total foreign exchange reserves is minimal.

109. If ANL operates on losses on the code-share routes, there is no foreign exchange earnings. Thus this public benefit claim does not hold. To minimise ANL's losses and to realise this public benefit, the ICCC considers it necessary to impose certain conditions as those in the previous Determinations; hence the test for an authorisation can be met and authorisation granted.

110. With regards to ANL's claim of inflation resulting in increased prices of imported vegetables and dairy products should the code-share be denied, while the ICCC generally agrees with ANL, it thinks that such arguments have to be properly quantified. The ICCC is also of the view that increases in freight rates will signal potential new entrants to enter the market; or ANL and Qantas may restructure to operate dedicated freight carriers which would create a more competitive environment which would in turn drive prices lower.

111. In relation to ANL's claim that its services of uneconomic domestic routes to satisfy public concerns may be no longer viable should the code-share application be denied, the ICCC notes that ANL failed to substantiate the link between the code-share and ANL's CSO obligation to the domestic routes. As far as the domestic routes and CSO is concerned, the ICCC does not consider such services to technically qualify as CSO, particularly since the loss-making component could not be quantified. While the Applicant argued that it had such obligations, there was only one such specific explicit request by Government and that was for the provision of the service to Japan.

112. Accordingly, the ICCC considers that this public benefit argument cannot be justified to hold much weight.

6.2.4. Air Freight

113. Like the others, the arguments here are the same as those put forward in the 2012 applications. The ICCC, therefore, would like to maintain its position in its freight authorisation of 2013 and the discussions in its 2012 authorisation.

114. Besides, the ICCC understands and acknowledges the vital role that airfreight services play in connecting PNG's domestic industries to international markets; especially for the import and export of perishable high-value commodities, like fisheries, vegetables and dairy products. The efficient movement of high value and time sensitive freight and mail aids PNG firms in their businesses which contribute to general growth of economic activities. Efficient air transport services assist PNG firms to compete internationally for the supply of goods to world markets.

115. The ICCC also notes from the statistics from the BITRE website, that apart from the fall in 2014, freight volume has been growing in the previous three years. As mentioned in discussions above, major projects such as Papua LNG, Stanley gas, P'nyang gas and Solwara 1, are coming on stream. Hence the market is expected to grow. If ANL pulls out of the market (due to non-reauthorisation), it is highly likely that potential new freight carriers would enter the POM/BNE sector because of the likely demand. However, as shown under Figure 4, freight traffic on the Sydney leg is not attractive for freight carriers to invest in that route.

6.2.5. Improvements to services and customer choice

116. As with other public benefit claims, similar arguments and issues have been put forward by ANL in regards to this claim. Hence rather than repeating the same discussions and views expressed in the 2012 authorisation, and given that no major changes have taken place in the market since 2012 authorisation was granted, the ICCC maintains the views expressed in its 2012 Determination. The ICCC is also of the view that without the code-share, for example, competition on the POM/SYD route will be missing and adverse competition effects are likely such as lessening of competition as a result of Qantas not competing (through code-share arrangement); hence monopolising of the route by ANL and the potential for air fare increase. Hence the ICCC is of the view that in the interest of maintaining competition on the POM/SYD route as independent operation is not viable at this stage as the traffic volume is far less than that of the POM/BNE route, code-share arrangement between ANL and Qantas is to the benefit of the travelling public. Based on this reasoning, the ICCC concurs with ANL's claim that generally the code-share alliance would bring about competition which may not be available without the code-share arrangement; and would lead to a wide range of innovative fare initiatives and frequent flyer enhancements to attract more passengers.

117. With the recent introduction of services to Port Vila, Vanuatu, Honiara, Solomon Islands, and Nadi, Fiji, the ICCC considers that ANL's continued

code-share with Qantas would benefit tourist travellers seeking connection flights from Australia into the tourist destinations in the Pacific.

118. With regards to the underutilization of the newly expanded terminal space, the ICCC is of the view that without this code-share, the terminal facilities will still be available and traveling public will still benefit. Hence the ICCC does not consider this as a benefit resulting from this code-share arrangement as, without the code-share, travelling public and all aviation stakeholders will benefit when they use the renovated Jackson's airport.

6.2.6. Efficiencies

119. ANL submits that the loss of the code-share would mean that the wide-body aircraft would have to be replaced with the narrow bodied aircraft for services between PNG and Australia. ANL states that the wide-body aircraft provides lower passenger costs and results in lower per passenger greenhouse gas emissions than carrying the same number of passengers on the narrow-body services.

120. The ICCC considers that the argument submitted by the Applicant stating that the wide-body aircraft is superior over the narrow-body aircraft, in terms of efficiency is not strong. If overall seat utilization and load factors, in terms of passengers and cargo, which govern profitability, were much higher, this would reduce per passenger/per tonne emissions and indeed show that the B767, wide-body aircraft was efficient. The fact that the Sydney route has been unprofitable in the past number of years and forecasts have showed ANL making a loss on the code-share routes from 2013 to 2015 suggest that load factors are low, ANL's code-share operations are inefficient and, on a unit basis emissions are likely to be higher from wide-body operations.

121. The ICCC also considers that any productive efficiency resulting from the code-share services would be far exceeded by the dynamic and allocative efficiency benefits arising from competition. A competitive market is better positioned to produce an efficient outcome and allocation of economic resources, than a market that is being interfered with, or which has unnecessary competitive constraints being placed on it by the behaviour of stakeholders.

122. Moreover, given that Australian market is a thin route in terms of traffic volume, independent operation is not considered as an economically viable option. This is shown under Figures 2 and 4 and explained elsewhere in this Determination. Even on the Cairns route where ANL and Qantas have independent operations, the parties are running at losses.

6.2.7. Likely effects on employment

123. While ANL argues that there would be job losses as a result of non-authorisation of this application, the ICCC maintains that displaced employees could find jobs within the industry. PNG's economy has been

predicted to continue the current trend of current growth[19]; thus the airline industry is set to grow, as there will be increasing demand for air travels. A positive sign has been seen in PNG Air's re-fleeting exercise.

124. ANL also states that with the loss of the code-share, it would have to become a smaller, less significant airline. The ICCC notes that the number of ANL's employees has increased since 2012; and would also like to acknowledge that ANL is one of the country's big employers.

125. The ICCC would like to make a clarification that when expressing its view in the previous determination that 'job losses would be temporary', the ICCC was referring to the aviation industry as a whole. While the job losses may be 'permanent' for ANL, the ICCC was of the view that it would be 'temporary' for the aviation industry as these employees displaced from ANL would find employment elsewhere in the industry once new airliners enter the market or existing airliners expand and there is demand for additional workforce.

126. The ICCC also considers that issues relating to aviation industry's employees need to be balanced against the benefits to the general public from the code-share arrangement. Whilst consideration may be given to unemployment effects and interests' of pilots and cabin crews, that need to be balanced against the detriments to the public and public benefits that would be realised if ANL were to reduce staff and restructure its operations so that it is more efficient and profitable, as discussed elsewhere in this determination, because ANL is an SOE.

6.2.8. National flag carrier

127. ANL claimed that there is a certain public bond that is derived from "the concept of a national carrier" and its' code-share with Qantas aids to maintain its wide-body services and underpin its strength as PNG's "national flag carrier" in a range of ways.

128. The ICCC notes ANL's arguments on this public benefit claim. The ICCC also acknowledges ANL's argument that the national flag carrier also has an important role to play in non-crises times as well. ANL mentioned how it had been nominated as the official South Pacific Games Carrier with the games logo being engraved on three of its aircrafts and the assistance provided to the PNG Games in November 2014.

129. The ICCC notes that most arguments here are similar to those argued in previous applications. Hence the Commission's position remains the same as the previous determinations. With the 'assistance' it claimed it has provided to PNG Games and South Pacific Games, whether these services were provided to the concerned people at no cost is unknown to the Commission. If they were done as part of its marketing, than it would be a commercially oriented exercise; and may not necessarily be considered as a public benefit to PNG from a viable national flag carrier.

[19] Discussion Paper No.144 of the National Research Institute, *"Mid-Year Review and Forecast of the PNG Economy – July 2015."*

6.3. The statutory test for authorisation

130. Applications made pursuant to section 70 of the ICCC Act are governed by the authorisation test set under section 77(6) of the ICCC Act. Section 77(6) provides that the:

"Commission (ICCC) shall not make a determination granting an authorisation pursuant to an application … unless it is satisfied that;

a) the entering into the contract or the arrangement or the arriving at the understanding; or
b) the giving effect of the provision of the contract, arrangement or understanding; or
c) the giving or the requiring of the giving of the covenant; or
d) the carrying out of enforcing of the terms of the covenant,

as the case may be, to which the application relates, will in the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition that would result, or would be likely to result or is deemed to result, from it."

131. Put simply, for the ICCC to grant authorisation, it has to be satisfied that the code-sharing agreement, if it is to be authorised, would, or would be likely to, produce benefits to the public that would outweigh the detriments to the public, including the lessening of competition.

6.4. Summary of arguments and weighing process

132. The ICCC's role is to ensure that the code-share arrangement is competitive and produces greater benefits to the public, as claimed by the Applicant. It is also to ensure the financial viability of ANL in its operations into the Australian routes for the continuation of the code-share.

133. The ICCC has noticed from previous ANL's applications, that ANL has been sustaining losses for certain Australian routes over a number of years. This did not add weight to ANL's public benefit claims regarding 'revenue for Government' and 'balance of payments'. However, as mentioned under 6.2.2 and 6.2.3 above, to minimise losses and to ensure that there is a continual stream of revenue for ANL regardless of peaks or troughs in the market, the code-share authorisations were granted with conditions. This ensures that ANL's financial position was strong and adds weight to public benefit claims given by the Applicant regarding 'revenue for Government' and 'balance of payments' which further ensure that public benefits outweigh the detriments and thus the test for an authorisation can be met and authorisation granted. Hence, as discussed, the ICCC considers it appropriate to impose such conditions in this application for the authorisation test to be met, if it decides to grant authorisation.

134. Without such conditions, there would not be such vigorous competition as has occurred between the code-share partners. Without the conditions also,

that continued stream of revenue for ANL and ANL's financial position may deteriorate. Hence, the public benefit claims mentioned above may not hold as much weight, which could lead to the authorisation being denied. The ICCC would like to maintain that current structure of the code-share agreement and the types of conditions imposed provide incentives for the code-share partners to be more competitive amongst themselves.

135. Beside the 'hard block' arrangement, certain conditions were set to ensure that the element of competition is realised to its full potential and potential public detriments are minimised. The conditions on maximum and minimum capacity requirements were set to ensure that there was aggressive marketing done on the part of Qantas and consumers benefit in terms of lower airfares. The maximum and minimum capacity requirements were also there for the parties to share risks across peak and low days and directions, thereby reducing ANL's losses and hence, losses to the public.[20] The Applicant also thinks that such conditions, *"... results in high level of competition between the carriers."* [21]

136. While noting Qantas' concerns on the types of conditions imposed on the parties that have affected its seat load factor on the PNG/Australia route compared to its overall international seat load factor, the ICCC thinks the difference is minimal. If Qantas markets more aggressively on the code-share routes, it would increase its utilization numbers to bring it up to its general seat utilization numbers.

137. In Qantas' submission on the Draft Determination, it maintained that its preferred outcome is reauthorisation without commercially restrictive conditions. The ICCC maintains that the conditions remain to minimise potential public detriments discussed earlier and encourage competition between the code-share parties in selling allocated seats and freight space.

138. On the freight code-share and the future independent entry of the code-share partners, the ICCC is of the view that this would impact on the dynamics of competition in the relevant market. This was discussed in detail in the previous Determination on the freight component of the authorisation. Arguably, if parties to the code-share authorisation enter the market independently, the market dynamics could change incentives for competition substantially. With greater combined market share, the parties could collaborate to extend their market position with the intention of extracting economic profits through increased freight rates. In normal competition analysis this would have resulted in a substantial lessening of competition.

139. Given the fact that Qantas independently entered the market and then withdrew in 2014, it is quite possible that it could do so again in the future. These two players, in those circumstances could then arguably operate as a cartel for the provision of air freight services, should one party enter the market independently on one hand, and collaborate in the code-share arrangement on the other.

[20] Determination A2012/13 page 59, para 7
[21] ANL submission, pg.5.

140. Besides the above, the ICCC also notes that the ability of wide-body aircraft and the resultant efficiencies in terms of transporting freight and passengers together on one flight, and the benefit to travellers in terms of networks for passengers', connections and multiple fare options are some of the outlaying public benefits unsurpassed by potential detriments.

141. Moreover, given the Australian market is a thin route in terms of traffic volume, the ICCC is of the view that independent operations is not an economically viable option to have continued frequency of services and flight options as currently offered. As mentioned elsewhere in this determination, the parties are 'bleeding' in their independent operations on the Cairns route; hence service levels in terms of frequency and different flight options are likely to be affected if parties have independent operations on the code-share routes.

142. The ICCC, however, considers it appropriate to have regard to situations where stand-alone services outside of the code-share may be necessary to airfreight specific type of cargos which the code-shared aircraft may not be able to carry. In light of the discussions above on competition concerns for independent operation by code-share partners, the ICCC will impose appropriate condition(s) to address this.

143. Airline competition in terms of code-sharing is somewhat increased since there is recognised potential for lower seat cost to the operator and lower airfare to the travelling public. The benefit of competition with a code-share is a desired public benefit hence supporting of authorisation is logical as opposed to individual airlines operating unviable routes with inflated airfares.

144. The argument that there would be a loss of air freight capacity and frequency as a result of not granting authorisation is arbitrary. The significant factors determining frequency and capacity are demand at present economic rates for freight and the ability of current competitors to meet that demand.

145. Code-share agreements also enhance the presence of an airline in markets where it would otherwise have no profile usually at the end of a route away from the airline's home country[22].

146. In respect of the period of authorisation sought, the ICCC considers that five years is too long. Given the current infrastructure investment by the GoPNG in the redevelopment of airports in the country and the emerging business activities in other sectors of the economy, the market dynamics might substantially change within the five year period from now. Hence the ICCC considers that lesser time would be appropriate.

[22] Competition impact of airline code-share agreements final report, p17

7. DETERMINATION

147. Taking into account the above analysis, based on information provided by the Applicant and submissions received from interested parties, the ICCC considers that, broadly, the renewal of this code-share agreement would result in net benefits to the public.

148. Since the code-share agreement has been entered into and this application is for renewal of existing authorisation, the ICCC also considers it appropriate to grant retrospective authorisation. This also covers the renegotiation of seat block allocation between ANL and Qantas.

149. The Commission, therefore, grants retrospective and prospective authorisation for this application. The ICCC grants this authorisation for a period of three (3) years commencing from the date the authorisation is effective. This authorisation is effective from the date this Determination is released.

150. As discussed in various parts of this Determination, to minimise potential public detriments and increase competition amongst the code-share partners, the ICCC considers it appropriate to impose some conditions pursuant to Section 77(2). **The ICCC may review the operations of this authorisation under Section 80 of the ICCC Act in the event any of the above conditions were not complied with.** The conditions are as follows:

    a) that, for passenger services for the Port Moresby-Brisbane route and the Port Moresby-Sydney route, ANL and Qantas comply with Annexure 1, the revised seat block;

    b) that, for freight services for the Port Moresby-Brisbane route, the marketing carrier be allowed to take not more than 40% (forty percent) of the total proportion of overall aircraft capacity for freight for every flight, in each direction, on every day of the week, throughout the year, for the duration of this authorisation;

    c) for the purposes of monitoring conditions a) and b) above, the code-share partners provide to the ICCC six (6) monthly yield and break-even load factor reports, for both passenger and freight, for the duration of this authorisation.

    d) that, the Sydney leg is not authorised for freight code-share services. Any future proposal to introduce freight code-sharing on that route would need to form the subject of a separate application at the relevant time;

    e) that, subject to condition f) below, if either party enters the PNG-Australia air freight market, as a regular cargo carrier, in its own right and outside the code-share agreement authorised by the ICCC, apart from existing passenger-cum-freight services on the Port Moresby-Cairns route and the Port Moresby-Sydney route, without an amendment to the code-sharing arrangement that reflects such entry and which is authorised by the ICCC prior to such entry, the freight component of this authorisation will cease forthwith;

f) that, if a code-share partner wishes to provide irregular services outside of the code-share agreement to carry *specific type of freight* which may not be suitable to carry on the code-shared aircraft, the code-share party intending to provide that service must give two (2) weeks prior notice informing the ICCC the type of cargo the carrier will carry and justify why independent service was necessary;

g) that, the parties must not collude on end-prices to be charged to customers under the code-share arrangements, nor on the capacity or frequency of services not covered by the code-share arrangements; and

h) that, ANL provides six monthly financial statements for each of the code-share routes to the ICCC.

MR. PAULUS AIN Commissioner/CEO	**DR ERIC OMURU, PhD** Associate Commissioner (Resident)	**MR. EDWARD WILLETT** Associate Commissioner (Non-Resident)

Dated 22nd April, 2016

Annexure 1 – Revised Seat Block allocated to Qantas

Day and Flight No	Route	AC TYPE	Total Seats		Seats allocated to Qantas			
			J	Y	J	Y	J (%)	Y (%)
Monday								
PX 2 / QF 313	SYDPOM	B738[23]	16	128	8	40	50	31
PX 3 / QF 350	POMBNE	B767	28	160	8	40	29	25
PX 4 / QF 349	BNEPOM	B767	28	160	8	40	29	25
PX 6 / QF 351	BNEPOM	B767	28	160	8	40	29	25
PX 5 / QF 352	POMBNE	B738	16	128	8	40	50	31
Tuesday								
PX 3 / QF 350	POMBNE	B767	28	160	8	35	29	22
PX 4 / QF349	BNEPOM	B767	28	160	8	35	29	22
PX 5 / QF 352	POMBNE	B738	16	128	8	35	50	27
PX 6 / QF 351	BNEPOM	B738	16	128	8	35	50	27
Wednesday								
PX 3 / QF 350	POMBNE	B767	28	160	8	35	29	22
PX 4 / QF349	BNEPOM	B767	28	160	8	35	29	22
PX 5 / QF352	POMBNE	B738	16	128	8	35	50	27
PX 6 / QF351	BNEPOM	B738	16	128	8	35	50	27
Thursday								
PX 3 / QF 350	POMBNE	B767	28	160	8	45	29	28
PX 4 / QF 349	BNEPOM	B767	28	160	8	45	29	28
PX 5 / QF 352	POMBNE	B738	16	128	8	45	50	35
PX 6 / QF 351	BNEPOM	B738	16	128	8	45	50	35
Friday								
PX 3 / QF 350	POMBNE	B767	28	160	8	45	29	28
PX 6 / QF 351	BNEPOM	B767	16	128	8	45	50	35
PX 4 / QF 349	BNEPOM	B767	28	160	8	45	29	28
PX 5 / QF 352	POMBNE	B767	28	160	8	45	29	28
PX 1 / QF 312	POMSYD	B738	16	128	8	45	50	35
Saturday								
PX 6 / QF 351	BNEPOM	B767	28	160	8	40	29	25
PX 2 / QF 313	SYDPOM	B738	16	128	8	40	50	31
PX 5 / QF 352	POMBNE	B737	12	104	8	40	67	38

[23] ANL operates two types of B737 air craft, a B737-700 and a B737-800. The latter being the larger of the two and is used on the Sydney route. Annexure 1, Revised Seat Block Allocations, above, shows the B737-800 as the aircraft type used for the Sydney POM route, however it is coded as 'B738'. This should not be confused as being another aircraft, it is the B737-800

Sunday								
PX 3 / QF 350	POMBNE	B767	28	160	8	35	29	22
PX 6 / QF 351	BNEPOM	B737	12	104	8	35	67	34
PX 4 / QF 349	BNEPOM	B767	28	160	8	35	29	22
PX 1 / QF 312	POMSYD	B738	16	128	8	35	50	27
PX 5 / QF 352	POMBNE	B767	28	160	8	35	29	22
TOTAL			664	4304	240	1180	36	27

Annexure 2 – List of stakeholders consulted

No.	Stakeholder	Response
1	Qantas	Submission Received
2	Airlines PNG	Advised that they will not be making a submission
3	Virgin Australia	Advised that they will not be making a submission
4	Travel Air	No Response
5	Hevilift	Submission Received
6	Tropic Air	No Response
7	Skyforce Aviation (Australia)	No Response
8	Pacific Air Express (Australia)	Indicated to give a submission, however no submission received
9	Department of Infrastructure and Regional Development (Australia)	Submission Received
10	Australian High Commission	Referred to above Submission
11	National Research Institute	No Response
12	Institute of National Affairs	No Response
13	National Airlines Corporation	Indicated to give a submission, however no submission received
14	Independent Public Business Corporation	Submission Received
15	Investment Promotion Authority	Referred to Previous Submission
16	National Fisheries Authority	No Response
17	PNG Tourism Authority	Submission Received
18	Civil Aviation Safety Authority	Have no issues and will not be making a submission
19	Port Moresby Chamber of Commerce and Industry	No Response
20	PNG Chamber of Commerce and Industry	No Response
21	Minister for Foreign Affair and Immigration	No Response
22	Secretary for Foreign Affair and Immigration	No Response
23	Minister for Trade Commerce and Industry	Submission Received
24	Secretary for Trade Commerce and Industry	Submission Received
25	Minister for Treasury	No Response
26	Secretary for Treasury	No Response
27	Minister for Public Enterprises	No Response
28	Minister for Transport and Infrastructure	No Response
29	Secretary for Transport and Infrastructure	Submission Received