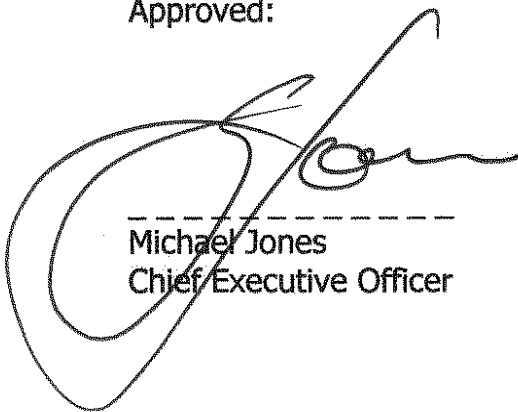


SUBMISSION NO. 116

**Submission to the House of Representatives  
Standing Committee on Transport and Regional  
Services inquiry into commercial regional aviation  
services in Australia and transport links to major  
populated islands**

16 September 2002

Approved:



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Michael Jones  
Chief Executive Officer

Secretary: *J. Lutter*  
REC'D  
20 SEP 2002  
HOUSE OF REPRESENTATIVES  
STANDING COMMITTEE ON  
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Emailed 18/9/2002

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## **Section One**

### **1. Introduction**

The House of Representatives Standing Committee on Transport and Regional Services has commenced an inquiry into commercial regional aviation services in Australia and transport links to major populated islands. The terms of reference for the inquiry are as follows:

- The adequacy of commercial air services in regional and rural Australia.
- Policies and measures required to assist in the development of regional air services, including:
  - regional hub services;
  - small scale owner-operator services; and
  - the deployment of most suitable aircraft types.
- The adequacy of commercial air services to major populated islands and the adequacy of alternative sea services.
- Interconnectivity between regional air transport systems, major national air services and international services (including on-carriage, through ticketing, freight handling, timetabling and airport slotting).
- The role of all three levels of Government in supporting and assisting the development of regional air services and island transport systems.
- The role of major air transport carriers in providing regional services.

Regional Express is delighted at the opportunity to provide the Committee with its perspective on regional aviation services within the terms of reference of the Committee.

### **2. Overview of Regional Express**

Regional Express or Rex was created on 1 August 2002 by the merger of Kendell and Hazelton Airlines to create a new regional airline servicing communities in regional New South Wales, Victoria, Tasmania and South Australia. Both airlines had previously been in administration for some eleven months following the collapse of Ansett Airlines.

Rex provides a vital transport service for regional and rural South Eastern Australia to the business, tourism, leisure, and family markets. The airline expects to carry some one million passengers this year (2002/2003).

It should be noted that the Standing Committee's inquiry occurs in one of the most challenging environments faced by the world aviation industry in decades:

- The uncertain Australian and world economies, including doubts about the sustainability of the US economy;
- The global over capacity in aviation;
- Increasing oil prices and weak Australian Dollar;
- The crisis of confidence in air travel following the events in the US;
- The financial stress facing many of the key global, domestic and regional operators;
- The collapse of Ansett Airlines last year; and
- The drought in regional Australia.

Headquartered in Sydney with its main operational, engineering and maintenance base at Wagga Wagga in southern New South Wales, Rex will employ approximately 620 staff. Customer relationship and reservation facilities are based in Orange and Burnie, and South Australia remains an important market and secondary maintenance base for the new airline.

The new airline is a high quality, efficient carrier operating twenty one Saab 340 A and B aircraft plus seven Metroliner 23 aircraft on routes in New South Wales, Victoria, South Australia, Tasmania and Canberra, focusing on regional markets. Rex services the capital cities of Canberra, Adelaide, Melbourne, and Sydney and 27 regional centres, with more destinations being introduced. Rex flies some XXX flight per week (A detailed destination map is attached.)

Both Kendell and Hazelton Airlines have proud and long histories of profitable service to regional Australia. This proud heritage is valued by the Board, management and all the staff of the new airline.

The Board and management of Regional Express are totally committed to providing outstanding and profitable aviation services to regional and rural South Eastern Australia. Rex has made and will continue to make solid commercial decisions about services, destinations and flights to ensure that the company quickly returns to financial strength and profitability.

Rex firmly believes that there are many opportunities to add flights and destinations to our the network of destinations. The airline is currently in discussions with communities across the network and evaluating the possibilities adding or enhancing services.

For example, on 23 August, Michael Jones, Chief Executive Officer announced in Mildura the creation from 14 October of a daily Sydney to Mildura service via Griffith and the upgrade of the Melbourne to Mildura service to a Saab 340 aircraft from a Metro 23 effectively doubling capacity.

Also from 14 October, Regional Express will commence operating twice daily to Traralgon, in the Gippsland region of Victoria. Adding this destination and upgrading the service to twice daily between Melbourne and Merimbula via Traralgon will provide additional choices for passengers and meets expressed community need for better aviation links to Melbourne.

On the other hand, Regional Express will withdraw services which are not supported, and are therefore not commercially viable. Rex has announced with the implementation of its new schedule on 1 September that it has withdrawn from Pt Macquarie, and rescheduled services from Merimbula and Moruya to Sydney to provide a better service and more seats with Saab aircraft.

The Port Macquarie service to the NSW north coast was not sustainable at the current passenger numbers. Prior to 1 September Rex offered three return flights Sunday to Friday and 2 return flights on Saturday, all continuing on to Lismore. In total there were some 240 seats per week allocated and available for Port Macquarie passengers.

In July 2002 the total number of passengers to Port Macquarie for the month was only an average of four per flight. In comparison the support from the Lismore community for the month was outstanding, with Rex carrying 2,663 passengers during the same period.

The commercial situation and the operational imperatives meant that the only responsible choice was for Regional Express to withdraw the service. Rex will continue to review the situation and is continuing discussions with the Port Macquarie community.

Looking specifically at services between Sydney and Merimbula via Moruya, the South Coast route incurred losses of approximately \$500,000 over the last three months of the 2001-2002 financial year with planes operating at an average load factor of approximately 38%. This is both unacceptable and unsustainable.

These losses can be attributed to overcapacity caused by the replacement of the 19 seat Metro aircraft with 34 seat SAAB aircraft with no reduction in frequency by the Administrators. Unfortunately Regional Express does not have the option to reinstate the Metro aircraft on the route as those aircraft were sold by the Administrators of Hazelton Airlines.

Instead, Rex has implemented a schedule with two daily round trip Saab services. This has resulted in capacity in the market which is slightly higher than that which existed prior to administration.

Because there are two roundtrip services per day, the services must originate in Sydney so that the aircraft can be utilized on other markets throughout the day. Rex has recognised local community concern about the amount of time available in Sydney and has amended the launch schedule to reflect an

evening departure from Sydney at 1720 (in lieu of 1650) and reviewing options for making the morning departure from Merimbula earlier, thereby providing even more time in Sydney for South Coast residents.

Regional Express will constantly look for improvements in schedules and utilisation of aircraft and, provided there is sufficient passenger demand from the South Coast, will continue to examine ways to provide the "preferred" schedule with more than the current 7 ½ hours in the Sydney CBD (allowing for transit both ways and 30 mins check in) for the South Coast business passengers.

Across the entire network, the first responsibility of the Board and management of Regional Express is to stabilize the business and reverse the current losses, thereby ensuring a future for the airline, its customers and its employees. Only then can the new company assess growth options, including increased frequency on existing routes.

The airline is focusing on the core airline business, and has therefore decided to outsource or dispose of the former travel agency businesses that the two airlines previous owned and ran. Rex was keen to minimize any inconvenience to both the staff and customers associated with these services. Accordingly, Rex has assisted former staff to set up companies to purchase the travel business and ground handling services that they formerly provided as employees. Where the former employees have not been keen to take over the business, Regional Express has undertaken negotiations with other companies or the relevant local government.

Passengers wishing to fly with Rex have three options to book tickets. Customers may:

- Call the reservations line on 13 17 13; or
- Utilise the state of the art online booking service at [www.regionalexpress.com.au](http://www.regionalexpress.com.au); or
- Contact their local travel agent.

Regional Express is confident that ticket prices are, and will remain, both competitive and sustainable over the longer term, while proving enough options for passengers. Rex has implemented a policy of being transparent about ticket pricing.

## **Section Two**

### **3. Responses to Committee References**

#### **1) The adequacy of commercial air services in regional and rural Australia.**

Regional Express believes that commercial air services in regional and rural Australia are at present inadequate and that this provides a business opportunity.

Despite substantial losses in excess of AUD\$3 million per month in administration, the management and group of investors who believed in both the need for regional services and the future potential of the business decided to proceed with the purchase of Kendell and Hazelton Airlines and the creation of Regional Express in August 2002. The Board and management are fully committed to regional, rural and coastal Australia and utilizing the opportunity that exists to rebuild a successful and profitable airline.

Notwithstanding this, Regional Express acknowledges that the provision of adequate commercial regional air services is a significant challenge for regional and rural communities; local, state and federal Governments; and airlines. It requires a balancing of the different demands including:

- the need at a difficult time in the aviation industry globally for airlines to be financially secure;
- the desire of regional and rural communities for new services or the enhancement of existing services;
- the costs applied and support provided by local, state and federal Governments;
- the competitive pressures and regulatory costs.

*Regional Express is committed to providing continued commercial aviation services to Regional Australia and believes there exist opportunities to add services and destinations, provided it makes solid commercial sense. Domain to this process the depth of the market and the competition provided by the major domestic players such as Qantas and Virgin Blue.*

#### **2) Policies and measures required to assist in the development of regional air services, including:**

- **regional hub services;**
- **small scale owner-operator services; and**
- **the deployment of most suitable aircraft types.**

Regional Express would like to suggest a number of potential policies and measures that would assist in the development and stabilizing of regional air services for the consideration of the Committee.

**(a) Regulated Routes**

In New South Wales routes below 20,000 annual passengers are regulated. The South Australian Government has recently passed legislation on regulating air routes. The Victorian Government does not regulate routes.

In addition Regional Express is of the opinion that the community service obligation aspect of routes with less than 60,000 passengers per year should also be recognized.

Regional Express submits that a consistent and uniform approach to the regulation of routes should be adopted. All routes with less than 60,000 passengers per year should be regulated.

The logic behind this is:

- Each route of this size would necessitate the use of one dedicated aircraft; and
- Each Saab 340/Dash 8 aircraft has approximately 36 seats.

Therefore to operate a viable and convenient schedule with an average of three roundtrips a day throughout the year means that there are approximately 78,840 seats offered each year. Allowing for seasonality and for an average load factor of 70%, this means that a "natural monopoly market" is approximately 55,000 passengers per year. One would want the market to grow beyond that 70% load factor prior to new competition, hence the 60,000 passenger cut-off.

Using a similar logic, routes with between 60,000 passengers and 120,000 passengers per year should be licensed to two carriers. Routes above 120,000 passengers (such as Coffs Harbour) should be open to full competition.

*Regional Express recommends that routes with up to 60,000 passengers per year be licenced to one carrier, that routes with between 60,000 and 120,000 passengers be licenced for two carriers, while routes above 120,000 be open to full competition.*

**(b) Anti-competitive behavior**

A significant ongoing threat to the survival of viable regional aviation services is the market power of other players. Examples of the misuse of market power by the major aviation carriers in regional markets have included:

- Dumping excess capacity from mainline routes into regional markets;
- The bundling of international, domestic and regional services for calculating corporate discounts; and
- The contracting out of State and Federal Government departmental travel arrangements to Qantas Business Travel agencies which results in the effective exclusion of other regional carriers.

**Capacity Dumping.** Dumping excess capacity from main line routes into regional markets occurs when aircraft which are not required outside the peak periods are used in regional markets. This activity makes it extremely hard for other carriers on the route to continue and possibly driving them off the route, to the detriment of the local community which may be left with a highly inappropriate schedule of services which fails to meet the needs of passengers and the community.

**Bundling.** The bundling of international, domestic and regional services by some carriers for the purposes of calculating corporate discounts makes it extremely difficult for carriers such as us at Rex, who are focused solely on regional market to offer an attractive enough corporate discount to attract the important and vital business / public servant market.

[It should be noted that such bundling is prohibited under US Law.]

In many Federal and NSW Government departments organizing travel arrangements for public servants has been contracted out to Qantas Business Travel. In practice this results in the effective exclusion of other regional carriers including Rex. Regional Express is aware of examples of, despite the explicit request to fly Rex, Qantas Business Travel agents booked flights with Qantas affiliated regional subsidiaries.

This anti-competitive outcome should be contrasted with the much more satisfactory policy of the South Australian Government which ensures all carriers carry South Australian public servants.

The ACCC and the Trade Practices Act are two vital components in ensuring fair competition in the Australian aviation industry. Regional Express recognizes that while the ACCC and the Trade Practices Act are being reviewed by a separate inquiry, the airline supports the amendment of the Act to implement the "effect" test for anti-competitive behavior.

### **(c) Cost relief**

The costs to regional airlines associated with landing fees, taxes and charges are a significant disincentive to the continued development of regional aviation services. The fees, taxes and charges are a heavy cost import on ticket prices which influences consumer choices.



Regional Express submits that independent regional carriers should get government support to reduce the cost impost of both aeronautical charges and landing fees at major airports. This would recognize the community service obligation nature of Essential Regional Services (i.e. all routes under our proposed 60,000 passenger level).

In addition, airport owners and operators have to adopt a realistic attitude to the application of fees and charges. Regional Express continues to raise this issue with many of the operators of the airports to which it flies seeking some form of relief.

On some regional routes serviced by the Rex the landing fees and airport charges, plus the Ansett levy of a flat AUD\$10 comprises some twenty per cent of the fully inclusive ticket price.

**Impact of Charges & Taxes on Regional Fares**

<b>Destination</b>	<b>Average Fare</b>	<b>Ansett levy</b>	<b>Airport Charges</b>	<b>GST</b>	<b>Full Fare incl charges</b>	<b>% of full fare</b>
Melbourne - Portland	\$120.00	\$10.00	\$16.80	\$14.68	\$161.48	25.7%
Melbourne - Mildura	\$120.00	\$10.00	\$12.21	\$14.22	\$156.43	23.3%
Melbourne - Albury	\$150.00	\$10.00	\$15.00	\$17.50	\$192.50	22.1%
Sydney - Orange	\$145.00	\$10.00	\$14.71	\$16.97	\$186.68	22.3%
Adelaide - Whyalla	\$105.00	\$10.00	\$6.45	\$12.15	\$133.60	21.4%
Adelaide - Mt Gambier	\$120.00	\$10.00	\$11.80	\$14.18	\$155.98	23.1%
Melbourne - Burnie	\$125.00	\$10.00	\$13.30	\$14.83	\$163.13	23.4%
Sydney - Canberra	\$100.00	\$10.00	\$8.46	\$11.85	\$130.31	23.3%

The Ansett levy should be withdrawn by the Federal Government from passengers traveling on regional routes with less than 120,000 passengers per year. The levy was originally introduced to ensure funds were available to cover the entitlements of staff of the Ansett and its subsidiaries. This justification for the employees of the regional subsidiaries Kendell and Hazelton Airlines is no longer relevant. Both airlines are operating and their employees (and their entitlements) are now the responsibility of Regional Express. [Any employee of the two airlines made redundant by the administrators has now been paid.]

*Regional Express recommends the removal of the Ansett levy on regional routes under 120,000 passengers per year.*

**(d) Insurance costs**

After September 11, the Federal Department of Transport and Regional Services provided Commonwealth Aviation Liability Indemnity to cover all airlines in Australia (free of charge). This was to help airlines cover the cost of the passenger terrorism charge levied on all airlines worldwide. The Hazelton cover was AUD\$100 million.

From 31 August 2002, the Government will charge for this Liability Indemnity. In Regional Express's case, the cost will be AUD\$3 per departure (turbo prop rate)

In the current environment, and with all other costs increasing, it is almost impossible to pass this additional charge on to passengers.

Regional Express submits that the Federal Government should consider three possible courses of action:

- 1) Eliminate the charge for regional services (or turbo prop operation);  
or
- 2) Continue with the fee but raise the liability cover (currently AUD\$100 million for Regional Express). For example, \$3 per departure covers up to AUD\$200 million; or
- 3) Combination of both options i.e. provide regional carriers AUD\$200 million liability cover for no charge (similar to cover prior to 31 Aug.)

Given the size of regional airlines, the scale of operation and the geography of operation, it can be argued that it is unfair and unreasonable to burden regional airlines with the same "cost per passenger" terrorism charge as a 747 aircraft operating from New York to Tel Aviv. However, commercial underwriters do not discriminate and as a result, Australian regional airlines bear the same cost per passenger as full service international carriers anywhere in the world.

If the Government were to offer AUD\$200 million insurance to Regional Express, the terrorism USD\$1.25 per passenger could be eliminated - this would represent a saving of AUD\$2.3 million to passengers and the airline. Given the razor thin margins operated by regional carriers, such a saving would be extremely significant.

*Regional Express recommends that the Federal Government provide regional carriers AUD\$200 million liability cover for no charge (similar to the cover prior to 31 August 2002.)*

**3) The adequacy of commercial air services to major populated islands and the adequacy of alternative sea services.**

Regional Express is one of the airlines providing services to King Island in the Bass Strait. Rex operates a daily service seven days a week from Melbourne using a nineteen seat Metro 23 aircraft.

Rex is committed to the service but has restructured operations on the island to ensure that the service remains commercially viable. Senior management has both visited the Island and continued to keep key stakeholders informed about the airlines plans for the King Island service.

**4) Interconnectivity between regional air transport systems, major national air services and international services (including on-carriage, through ticketing, freight handling, timetabling and airport slotting).**

Continued easy access to the domestic and international terminals at the major airports is a vital requirement for regional passengers. Regional Express submits that continued vigilance is required to ensure that regional passengers are not discriminated against by the major capital city airport operators in the provision of landing slots and terminal access to independent regional airlines.

Regional Express is grateful for the Federal Minister's assistance in ensuring that the airline's landing slots at Sydney Kingsford Smith Airport are guaranteed until 2008.

**5) The role of all three levels of Government in supporting and assisting the development of regional air services and island transport systems.**

Regional Express is grateful for the support provided by all levels of government to assist in finalising the purchase of Kendell and Hazelton from the Administrators Sims Lockwood and Korda Mentha and Colleagues, and in launching the new airline.

The Federal Government, the Deputy Prime Minister and Minister for Transport, his office and the Department of Transport and Regional Services all played a key role in the successful purchase of Kendell and Hazelton airlines. Also of great support was the assistance provided by Mrs Kay Hull, federal member for Riverina.

The New South Wales and South Australian State Governments also provided critical support at vital moments. The NSW Government assisted with pay roll tax and stamp duty concessions for example.

Local Government plays a critical role in the provision of regional aviation, firstly as a major owner and operator of aerodromes and secondly in the support of marketing and promotion of local and regional travel and tourism.

The support that Local Government has provided or shown a willingness to provide to Regional Express has been very useful. For example the Latrobe City Council, in the Gippsland region of Victoria is assisting with the marketing of the new Rex service between Melbourne and Traralgon.

State and Federal Governments can assist independent regional carriers without any real budget implications, by ensuring independent regional carriers a fair share of government business.

For example, approximately AUD\$350 million dollars worth of government travel is currently negotiated in the ACT. Currently the regional component of this all gets wrapped up in the bid which means that Qantas has a virtual "lock" on the business. Furthermore, QBT manages the accounts for the Government which means that non Qantas carriers are lucky to see any of the travel spend.

If true independent regional carriers (i.e. not Qantaslink) were to get a share of this traffic it would make a tremendous difference to their viability. In addition, Rex should be able to get a percentage of business out of Canberra proportionate with our capacity share in and out of the city.

*Regional Express recommends that both State and Federal Government's adopt a policy of allocating a fair share of government travel business to independent regional carriers.*

**6) The role of major air transport carriers in providing regional services.**

In a properly regulated competitive market, where the major air transport carriers can not misuse their market power, the major carriers can play an important role in the provision of aviation services for regional markets. The provision of competition is healthy for both the economy and the passengers serviced.

However, without assistance, monitoring and some form of regulation the competition could get to the point where the survival of dedicated regional airlines was jeopardized.

Attachment One – Route Map

