

Ref 5/7/72

DM:SC

Committee Secretary
House of Representatives
Standing Committee on Transport and
Regional Services
Parliament House
Canberra ACT 2600

Dear Sir/Madam,

**Re: Inquiry into Commercial Regional Aviation Services in Australia
and Transport Links to Major Populated Islands**

On behalf of the municipalities of Southern Grampians Shire, City of Warrnambool and Moyne Shire, I wish to present to the Standing Committee a submission on the potential need for a regular public air service between the cities of Hamilton, Warrnambool and Melbourne.

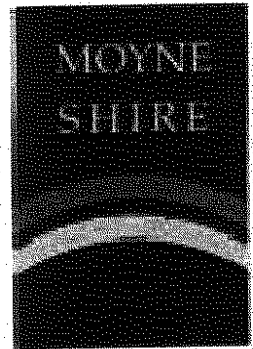
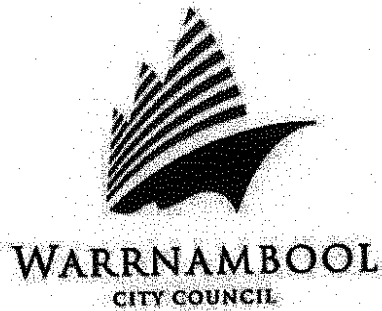
This submission is strongly supported by the three municipalities representing a 60,000 plus population catchment and Sharp Aviation, Hamilton.

If requested by the Standing Committee, we would welcome the opportunity to give a personal presentation to the inquiry.

If you require further information, I can be contacted on telephone (03) 5573 0434 or email, david_miller@sthgrampians.mav.asn.au. My postal address is Locked Bag 685, Hamilton, VIC, 3300.

Yours sincerely,

David Miller
Executive Manager, Economic Development
Southern Grampians Shire Council



HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON TRANSPORT AND REGIONAL SERVICES

Inquiry into commercial regional aviation services in
Australia and transport links to populated islands 2002

SUBMISSION ON BEHALF OF
SOUTHERN GRAMPIANS SHIRE COUNCIL
CITY OF WARRNAMBOOL
MOYNE SHIRE COUNCIL



CONTENTS

A.	INTRODUCTION.....	1
B.	SUMMARY OF KEY POINTS.....	2
C.	BACKGROUND	3
D.	CHARACTERISTICS OF REGIONAL AIRLINE SERVICES	6
E.	ADEQUACY OF HAMILTON & WARRNAMBOOL REGIONAL AIR SERVICES.....	11
F.	POLICIES AND MEASURES REQUIRED TO DEVELOP AIR SERVICES.....	12
G.	REGIONAL AIR SERVICES - INTERCONNECTIVITY	16
H.	ROLE OF GOVERNMENT(S).....	17
I.	REGIONAL SERVICES – THE ROLE OF MAJOR AIR TRANSPORT CARRIERS	20



A. INTRODUCTION

The Federal Minister for Transport and Regional Services has requested that the Standing Committee on Transport and Regional Services conduct an Inquiry into commercial regional aviation services in Australia and transport links to major populated islands.

This submission is presented to the Inquiry by Aviation Business Pty Ltd (Airbiz) on behalf of three regional local governments in south-western Victoria being:

- The City of Warrnambool
- The Southern Grampians Shire, and
- The Shire of Moyne

Each of the municipalities has sole or shared ownership and management of a regional airport:

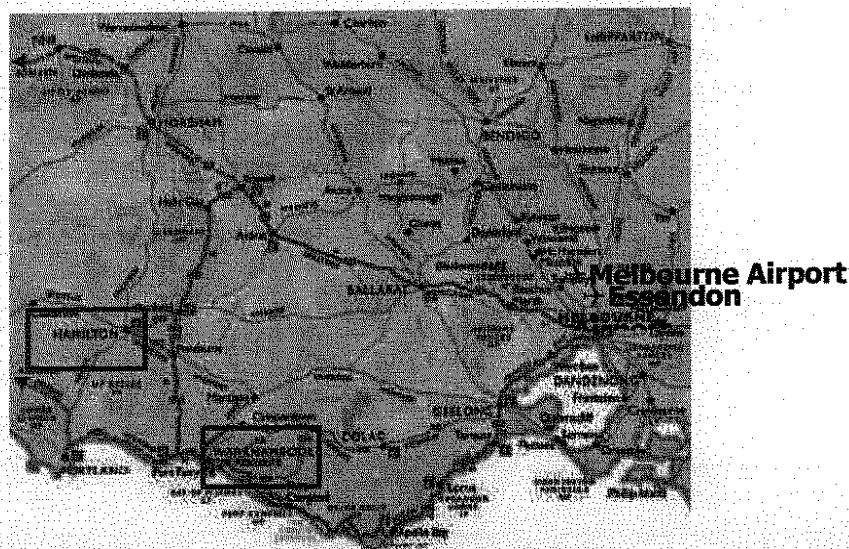
- Warrnambool Airport (City of Warrnambool/Shire of Moyne)
- Hamilton Airport (Southern Grampians Shire)

Although the regions served by the respective councils and airports have significant population, industry and tourism bases as well as social and business connections, particularly to Melbourne, neither centre benefits from scheduled air services.

The councils recognise their roles as partners and facilitators in regional growth and are anxious to encourage the commencement of air services in the near future.

Recognising that there are barriers to entry for an operator, the councils are committed to finding means that these barriers may be lessened, to an extent that an airline operator becomes sufficiently confident to start services to each of the airports. Accordingly the councils welcome the initiative by the Minister for Transport and Regional Services to request the House of Representatives Standing Committee on Transport and Regional Services to inquire into commercial regional aviation services.

This submission is confined to the commercial regional aviation services aspects of the Terms of Reference and offers no comment in regard to air or sea services to major populated islands.





B. SUMMARY OF KEY POINTS

The key recommendations that this submission presents, and which are discussed in more detail later, are:

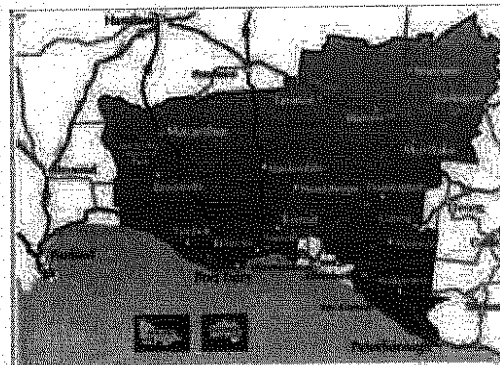
- That the Victorian State Government should:
 - Intervene in the regional airline market place and license selected "thin" routes
 - Develop a strategic plan for regional airports and air services in the state
 - Allocate funds in regional programmes to support feasibility studies and the preparation of business plans by potential start-up airlines for new or expanded routes
 - Make an annual allocation from the Regional Infrastructure Development Fund (RIDF) to support local governments to upgrade airport facilities to support new and existing airline operators where the standard of facilities has declined below acceptable levels
 - Review its Victorian Tourism Plan to ensure it includes supporting regional air services through stimulation of tourism growth
- That the Commonwealth Government should:
 - Facilitate access to soft loans for new start up airlines on thin regional routes,
 - Provide aviation fuel tax rebates for the first 12 months of a new regional airline service, and
 - Continue the waiver of Airservices Australia en route charges for regional air services
 - Continue subsidy support to Airservices Australia for reasonably priced tower services
 - Extend flexibility of the Regional Assistance Programme to provide assistance for local governments to undertake economic benefit and feasibility studies into starting air services
 - Ensure that the ACCC monitors the commercial behaviour of the two major domestic carriers and major regional carriers in any response to small regionally based carrier start-ups on previously unserved routes
 - Review the proposed CASA Part 121B CASR to ensure it does not make it harder for small country based operators to exist
- That local governments should actively encourage airline start-ups through a combination of partnerships:
 - Preparing feasibility and market demand studies,
 - Undertaking promotion to communities and business,
 - Facilitating complementary tourism developments,
 - Providing appropriate airport amenities, and
 - Liaising with and lobbying State and Commonwealth governments



C. BACKGROUND

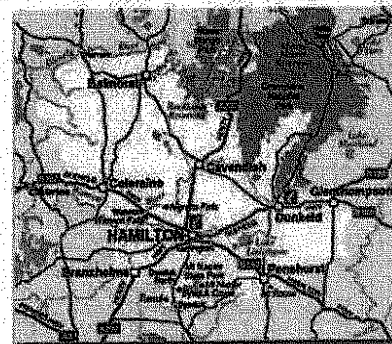
The Regions

The South-West Region of Victoria is a popular tourist destination for both domestic and international visitors, with the major attraction being the Shipwreck Coast. Warrnambool, supported by Port Fairy, is well positioned as a major stopover for visitors to this coast. Warrnambool is Victoria's fifth largest city, population 29,500, and is located in an area of the state renowned for its spectacular natural beauty and turbulent maritime history. The city boasts a strong business presence and is a popular tourist destination for international and Australian visitors.



The Shire of Moyne is characterised by its significant agricultural production, growing tourism industry and thriving industry. The Shire covers an area of 5,500 square kilometres and has a permanent population of 16,350, which significantly increases during festivals and holiday periods.

Southern Grampians Shire is located in the centre of the Western District of Victoria, 290 kilometres west of Melbourne and 500 kilometres south east of Adelaide. With a population of 17,100, Southern Grampians covers an area of 6,700 square kilometres. Hamilton, population 9,250, is the main retail and service centre for the smaller towns of Cavendish, Coleraine, Dunkeld, Glenthompson, Branxholme, Balmoral, Penshurst, Byaduk and Tarrington. Hamilton is recognised as the centre of the shire for business and commerce, education, health, cultural and recreational facilities and services. Today, 10% of the world's apparel wool is produced within a 200 kilometre radius of Hamilton.



Warrnambool Airport

Warrnambool Airport is located 13 km from the City of Warrnambool, in the Shire of Moyne. It has two runways, 04/22 and 13/31. Runway 13/31 is sealed and 1372 metres long. This makes the airport suitable for operations of almost all propeller aircraft in common passenger service. RAAF Hercules C-130 aircraft and a privately operated business jets occasionally use the airport. However, runway length can prove restrictive on hot days for turbo-prop and jet operations.

The terminal is a simple brick building with seating for 12-15 in a combined check-in/waiting area and has only basic facilities.

Hamilton Airport

Hamilton Airport is located 11 km from the City of Hamilton. The airport has two runways, 10/28 and 17/35. Runway 17/35 is sealed and 1404 metres long. This makes the airport suitable for operations of almost all propeller aircraft in common passenger service and is regularly used by visiting business jets, RAAF VIP jets and once a Boeing 737-200. All jet services require pavement concessions.



The terminal was built in the mid-1980's and comfortably handles up to 30 arrivals and departures at once. The terminal building is in excellent condition as are the T-VASIS instrument system and the runways.

Historic Air Services

Hamilton has a long history of supporting commercial air operations. Ansett Airlines originated from Hamilton. From the 1970s Ansett operated Fokker 27s on a triangular route with Hamilton and Mount Gambier, South Australia. Anecdotal evidence indicates that an average of 12 passengers was picked up and set down at Hamilton for each service.

Ansett also serviced Warrnambool using a Fokker 27 throughout the 1960s and 1970s. This service ceased around the same time as the service to Hamilton, around 1981/82. Services were taken up by Kendell Airlines operating 19 seat Metroliner 23 aircraft on up to 6 services per day. Kendell Airlines serviced Warrnambool from January 1982 – May 1985, but ceased operations due to demand proving non-viable. Kendell was offered license-protected routes by the South Australian Government in 1986. These routes were taken up to the detriment of the remaining Hamilton and other Victorian services.

Since that time several operators have attempted services from Hamilton and Warrnambool. Firstly, Biz Jets Ltd operated Cessna 402 flights connecting Warrnambool to Melbourne in the late 1970's and early 1980's. Staywood Air flew a triangular route between Warrnambool, Hamilton and Essendon for approximately 2 years between 1986 and 1988. This service operated for two years, but failed apparently due to high interest payments on the aircraft. Flinders Island Airways then took up the route but the services, using Piper Navajo and Chieftain aircraft of 8 and 9 seats respectively, ceased in 1990. Subsequently, Flinders Island Airways serviced Hamilton and Warrnambool for three years but a change in management brought a change of focus away from RPT in favour of freight.

Current Intrastate Air Services

Currently, there are no regular passenger transport (RPT) services to or from Hamilton or Warrnambool. Charter services occur frequently from Hamilton, mostly operated by Sharp Aviation.

The nearest air service links with Melbourne are operated from Portland. From Portland, Sharp Aviation flies a triangular route linking Avalon Airport and terminating at Essendon Airport in Melbourne, using a 9 seat Piper Navajo Chieftain aircraft. Regional Express, using 19 seat Metroliner 23s, services Portland with a triangular route linking Mount Gambier South Australia and terminating at Melbourne International Airport. Portland is a one-hour drive from both Hamilton and Warrnambool but in the opposite direction to Melbourne.

Mildura is the only intrastate service that Qantas, through Airlink, operates in Victoria.

Potential Air Services

The Airport Reporting Officer for Hamilton Airport reports frequent inquiries for passenger air transport to Melbourne are received each week. There is evidence of latent demand for



business travel and the proposed Mineral Sands project will add additional demand for air access to Hamilton.

Consultation with businesses¹ in the Warrnambool region reveals evidence of a moderate level of demand for a regular air service to and from Melbourne.

In particular, the manufacturing businesses of Warrnambool Cheese and Butter, Murray Goulburn, Nestle and Midfield Meats have signalled a latent demand for a regular air service with Melbourne through the potential travel of their employees as well as domestic and overseas visitors.

A conservative estimate of the potential business traveller movement demand is in the order of 4000 per annum from Warrnambool. At least another 2.500 passengers per annum would be generated by tourism and VFR² travel.

¹ Warrnambool Regional Airport, Economic Feasibility Study, 2001

² VFR: Visitor, Friends and Relatives



D. CHARACTERISTICS OF REGIONAL AIRLINE SERVICES

Definition of Regional Air Services

Regional airlines provide scheduled Regular Public Transport (RPT) services within Australia, generally linking smaller rural centres with the principal cities.

The DoTaRS definition states that "to be classified as a regional airline, its fleet must comprise exclusively low capacity aircraft, currently defined as aircraft with fewer than 38 seats, or with a payload of 4,200 kg or less."

"In spite of this definition, a number of airlines operating aircraft in the 50-90 seat capacity range are regarded as regional airlines" (DoTaRS 2002). Examples of these include Qantas subsidiaries Qantaslink and Southern Airlines that operate 117 seat Boeing 717s and 87 seat BAe 146s.

Characteristics of Regional Air Services

In Australia some city pairs may be classed as regional for the statistics gathering purposes despite generating high volumes of passengers and being serviced by large jet equipment. Examples of such routes include Canberra-Sydney or Coolangatta-Sydney.

It is this variance in the scale of routes classified as regional that, in part, has led to the demise of services for very low-density routes such as Hamilton-Melbourne. To be competitive as a business, airlines must seek economies of scale by using aircraft of a capacity and operational characteristic that suit a broad range of routes.

Currently, the equipment most commonly used in Australia are 37 seat Dash 8-100's, 36 seat Saab 340's or 19 seat Metroliner 23 aircraft. A break-even load factor for air services is usually between 50-60% of seats available. Even for the 19 seat aircraft this break-even point is often beyond the sustainable generating capabilities of small regional areas.

Airlines prefer not to operate a wide variety of aircraft types as it increases fixed costs such as pilot and maintenance training, spare parts inventory and other costs. This has led to low density routes, such as Hamilton-Melbourne and Warrnambool-Melbourne, appearing to be uneconomical to operate for medium to large regional airlines. Subsequently these communities are left either unserved or inadequately serviced.

Despite the appearance of an untenable business situation on very low-density routes, there remains an ongoing and unmet demand for air services to and from regional centres in Victoria, to Melbourne. It has previously proven profitable for air services to operate to such areas if the operator is unencumbered by excess capacity needed to serve medium and high density routes.



Regulation

The overall trend has been toward deregulation of the commercial aviation industry over the past two decades but there is still evidence that regulation can ensure community access to sustainable air services on thin routes for regional Australia.

The Commonwealth does not regulate intrastate aviation and the State governments have the power to regulate at this level.

The approach across State Governments in Australia is varied.

Victoria – has never regulated

Tasmania – has previously regulated, but deregulated in 1997

Queensland – regulates through the Transport Operations (Passenger Transport) Act 1994. Its approach is to have the power to restrict market entry, thereby protecting an operator from potential competition if there is demonstrable community benefit to do so. There is also provision for service contracts between the Government and an airline – this could provide exclusivity on a route and if a fee is paid by the Government under the service contract, this amounts to a route subsidy.

New South Wales – regulates through the Air Transport Act 1964. Here the approach is to restrict access on licensed routes to licensed operators, thereby effectively controlling the number of operators on a particular route. NSW moved towards deregulation in 1998, but did not proceed and therefore the status quo remains. Some modification occurred in 1999 when restrictions to access were lifted from some 17 routes of between 20,000 and 40,000 annual passengers NSW does not provide subsidies to operators.

Western Australia – regulates through the Transport Coordination Act 1966 WA. Its approach is to license the activities of an aircraft (quite different than NSW/QLD and as proposed by SA). Currently WA subsidises four routes in conjunction with local government, tourism and private sector.

The WA Government has a comprehensive strategic plan – *Air Transport Directions for Western Australia*, setting out its policies and action plans for the state's aviation sector.

South Australia - Prior to September 2001, all SA regional route operations were subject to market forces. SA has never regulated, but has prepared a draft Bill³ to do so.

Under the Bill's draft provisions, it is conceivable that the responsible Minister may declare a licensed route based on a number of criteria – demand, operator intentions, economic or social

³ Air Transport (Route Licensing – Passenger Services) Bill 2002



costs suffered by a community if the route is not declared, improvements anticipated, alternative transport options. The proposed licence duration might be limited to 3 years.

This Bill has been prepared because since September 2001, there have been many service withdrawals causing significant disruption to communities. The marginal profitability of some routes leaves potential alternative operators reluctant to take the risk to invest in either picking up an unserved route, or entering a route already serviced in competition.

Competition

In its 1999 study into Regional Aviation Competitiveness (Working Paper 41), the Bureau of Transport Economics (BTE) examined trends in the behaviour of the regional air services industry to gauge an indication of its competitiveness. The BTE gave two principal reasons for doing so – the importance of an efficient regional air services sector as a contributor to the infrastructure that serves rural and remote communities – and to determine the effectiveness of deregulation as a driver towards competitiveness.

The BTE noted, however, that despite the objectives of the preceding deregulation, that there is a notably high proportion of regional routes with only one operator.

There has also been evidence of withdrawal of operations from numerous routes through and since the period of deregulation.

The BTE study highlighted the dominance of the major domestic operators, either directly or through their alliances with regional airlines. At the time of the work, the major domestics, Qantas and Ansett, dominated the industry, either through their own flights or those of subsidiaries and alliance partners – only 3% of regional passengers were being carried by what could be deemed to be truly independent carriers.

Since the 2001 collapse of Ansett, there is currently only one major domestic group, Qantas, which has increased its services in some regions. As services are resumed by a number of carriers previously part of the Ansett group (e.g. Kendell and Hazelton), it could be said that the dominance of the majors has been significantly reduced. However, it is not unreasonable to foresee that Virgin Blue will progressively generate alliance relationships and the situation could again revert to domination by two main domestic carrier groups.

It is also a truism that aviation markets need to be of a reasonable size to successfully sustain competition. This has been part of the rationale historically used to justify route licensing and/or subsidisation by some state governments, to ensure stability of services to small remote communities.

In the case of NSW, the historical "rule of thumb" applied was that routes with fewer than 40,000 annual passengers were best serviced by a single operator (BTE). This translates to between 2-3 return services per weekday (less in weekends) using a Dash 8-100 at 60% load factor (practical if just one operator) or alternatively close to 6 return services per day using 19 seat Metroliners (practical if two operators on the route). Observed in this simple manner, the 40,000 passenger breakpoint appears pragmatic.



The NSW government moved towards deregulation to a small extent in 1999 allowing competition on "open routes" which were extended in general terms to include all routes with traffic levels exceeding 20,000 annual passengers. Given that this revised threshold is just 50% of the previous guideline, it is unlikely that this partial deregulation would have contributed much towards fostering increased competition on the affected routes. Rather, it is expected that the single operator incumbents would continue to be unopposed (not able to be examined in detail for this submission).

In its 1999 submission to the H.O.R Standing Committee on Primary Industries and Regional Services Inquiry into Infrastructure and the Development of Australia's Regional Areas, Qantas Airways proposed its view of a 100,000 annual passenger threshold below which competition on a regional route would be impractical. Associated with this, Qantas noted that one of its regional subsidiaries, Eastern Airlines, was planning to phase out aircraft with fewer than 36 seats (i.e. all smaller than Dash 8-100). Clearly the Qantas view on the threshold of practical competition would be influenced by the trends of its regional subsidiaries to move to increasingly larger aircraft (thereby requiring larger market sizes to maintain reasonable density of frequencies) combined with a natural desire on its part to protect the single operator routes enjoyed by its regional subsidiaries.

Pricing

The BTE study previously referred to (Working Paper 41) examined the behaviour of airlines in terms of setting airfares across routes with single and multiple operators. The BTE concluded that there was no obvious trend apparent towards airfares being different on routes without competition – in general the BTE considered that airfares were generally in proportion to the sector length. The BTE also reported that airfare levels appeared to be reasonably consistent across the States examined.

The BTE work acknowledged that there would be some risk or potential for uncompetitive pricing in the regional industry because of the predominance of major carrier alliances and routes with single operators. However, the report concluded that there was little or no evidence that such practices were occurring, despite the structural characteristics of the industry.

A key conclusion to be drawn from this is that fears of price gauging occurring when a single operator services a regional route are not likely to manifest in reality.

Barriers to Entry for New Operators

There have been identified a number of potential barriers to the entry of a new competitor or operator in a given market. These include:

- **Access to production inputs**, in this case airport gates, fuel, aircraft and working capital
- **Access to markets**, in this case the ability to sell to potential customers through travel agents, computer reservation systems, interline/connectivity availability
- **Threat of direct competition**, in aviation this has previously been seen as capacity dumping, price fixing and other abuses of market power by incumbent airlines



➤ **Threat of substitution**, i.e. road or rail links from South Western Victoria to Melbourne

In the current deregulated environment any potential operator carries all the risk presented by the above factors, despite the clear potential benefits to the wider community. Airlines are unique amongst service industries because of the large capital investment required in aeroplanes, the complexity of regulatory requirements and the dispersed geography of potential customers.

As has been identified above, existing regional airlines are not in a situation that could provide a sustainable business on very low-density routes. Yet it is conceivable, if not likely, that incumbent airlines would seek to block the establishment or expansion of small operators on very low density routes, so as to pre-empt growth by such operators on to medium density routes in the future. Small-scale owner-operators do not have sufficient resources to survive a concerted competitive challenge by incumbent operators.

Apprehension that entry on to an unserved route could evoke strong competitive response from a major domestic carrier, less concerned about profitable operations on that route and more to constrain growth of small independent operators could be readily addressed by licensing at a State level.

Although the Commonwealth Government no longer seeks to directly regulate or subsidise airlines in Australia, there are indirect measures that would act to incubate very small operators on very low-density routes, so as to ensure entry and facilitate community service. These are outlined in Section G.



E. ADEQUACY OF HAMILTON & WARRNAMBOOL REGIONAL AIR SERVICES

Regional airline services to Hamilton and Warrnambool are inadequate, as there are no scheduled services to Warrnambool and Hamilton and there have been no services since the mid 1980's.

Past history exposes the issue of operators using aircraft too large for the size of the market. For example, 19 seat aircraft such as the Metroliner and Jetstream 31/32 have not achieved sustainable load factors.

Kendell's history of operations into Portland supports this issue as they have, in the past, needed to triangulate most of their schedules through Mount Gambier to attempt to achieve viability.

In recent years Sharp Aviation has made a concerted effort to service centres in south-western Victoria. Sharp Aviation is based in Hamilton providing predominantly flying training and charter services. Sharp's major passenger service has been initially by way of a charter service from Portland via Avalon Airport to Essendon Airport, which was underpinned by a passenger contract from Alcoa. This is now operating as a scheduled airline service and Sharp Aviation has undertaken some preliminary business planning in regard to the future expansion of its operations in south-western Victoria.

With the demise of Ansett/Kendell last year, Sharp Aviation expressed a clear interest in expanding its airline role out of Portland. A submission was sent to Department of Transport and Regional Services under the Rapid Route Recovery Scheme. This submission was essentially ignored in favour of providing financial support through the Ansett Administrators to maintain Kendell operations on existing routes (in this case Portland), irrespective of whether the route was viable. The Department did not, or could not, consider alternative approaches that may have resulted in an improved amenity for the Portland Region through direct services to Melbourne.

In effect, a failing business received the support while an enterprising business was ignored.

Sharp Aviation operates 9 seat aircraft, which are better suited to the current demand profile of communities such as Hamilton and Warrnambool.

The negative response by the Commonwealth Government to Sharp's proposals, the subsidisation of Kendell on the Portland route and now, the uncertain route aspirations of Regional Express do not provide encouragement for a new entrant considering establishing new services in south-western Victoria.



F. POLICIES AND MEASURES REQUIRED TO DEVELOP AIR SERVICES

Despite the Commonwealth Government having deregulated domestic and applying minimal direct intervention in the airline industry, there are a number of indirect measures that would be of significant assistance to very small carriers in entering low-density markets. Such measures could include:

- Insurance underwriting - such as being insurer of last resort, similar to the UK
- Tax relief - targeted tax exemptions, with sunset clause, could lower operating costs thereby making marginal routes more attractive
- Training - an education programme or programmes especially for regional aviation positions delivered through outlying TAFEs or similar institutions
- Regulatory assistance targeted at very small operators - this could include
 - A review of the proposed CASA Part 121B CASR to ensure it does not make it harder for small country based operators to exist
 - Extra help in achieving an Air Operators Certificate
 - Relief from a proportion of CASA fees and charges
 - Guaranteed landing slots at regional hubs
 - Airspace reform for small aircraft
 - Regulatory access to common user terminals
- An ongoing monitoring of service delivery and competition on very thin routes

From a State perspective, if Hamilton and Warrnambool are to achieve regional airline services then changes in the policies of government(s) are required and measures implemented to encourage and protect small-scale owner-operator services and influence the deployment of the most suitable and commercially viable aircraft types on these routes.

Of significance is the prospect of the Victorian Government introducing some form of regulation on thin intrastate routes which this is discussed under "Small Scale Owner Operator Services".

Regional Hub Services

Victoria, in contrast to say Queensland and New South Wales, is a relatively small state and Melbourne represents the only significant regional airline hub. The opportunity for mini hubs to be formed appears to be remote and is not an issue for Hamilton or Warrnambool's aspirations.



Small Scale Owner Operator Services

Whilst this submission supports, in principle, the benefits of competition and market forces, the principle does not necessarily provide benefits at all levels of the aviation industry.

The Committee should recognise:

- That pure market models may not be appropriate in all circumstances
- That market failure has occurred in a number of regional and rural areas – Warrnambool and Hamilton are examples
- Major domestic carriers (Qantas, previously Ansett, possibly now Virgin Blue) have fleets with increasingly larger aircraft, generally all jet – unsuitable for regional services – and understandably they have no “interest” in providing the regional services directly themselves
- That even the larger regional carriers (previously Kendell, possibly now Regional Express) may have difficulty in resuming air services to Warrnambool and Hamilton, due to unsuitability of aircraft and/or risk mitigation
- That small owner-operator businesses probably represent the may be the appropriate means for resuming withdrawn air services to cities such as Warrnambool and Hamilton
- That the risks for small owner-operator businesses are very high in proportion to the rewards that they stand to achieve and/or the benefits that the wider community being served may accrue

It is suggested therefore that that the Committee should recommend the formulation and adoption of policies and implementation of measures that address these issues by:

- Reducing the barriers to entry for small operators
- Providing financial support through rebates on charges, or
- Providing access to soft loans for aircraft acquisition, and
- Monitoring the performance and competitive (and potentially anti-competitive) behaviour of regional airlines

The policies and measures might include:

- Licensing of routes
- Short term subsidies
- Access to soft loans
- Fuel tax rebates
- Business Plan funding programs
- Grants for airport infrastructure upgrades

The most significant of these policy options would be the State Government licensing regional airline operations within Victoria.



The Case for Regulation/Licensing

Licensing a thin route to a single operator may significantly reduce the risk of investment in the route.

A licence awarded in a competitive process may provide confidence and certainty to bring forward investment in the services.

It should encourage small local operators to consider establishing services.

It would block predatory entry by a competitor to force the incumbent airline off the route.

It would ensure better matching of aircraft capacity to regional community demand.

Deployment of most Suitable Aircraft Types

If an airline service to a small regional community is to be efficient, sustainable and offer the lowest cost airfares then the type of aircraft must match the typical passenger demand and load factors during the peak demand. That is, the route must be commercially viable on its own without cross subsidy from other routes.

The recent experience in regard to Kendell's operation from Portland showed that a 19 seat aircraft was not appropriate as it was averaging loads of less than 10 seats per service prior to the Ansett demise. During the period of the subsidy from the Rapid Route Recovery Scheme this was even worse with loads of some 3 to 5 seats per flight.

Kendell Airlines at Portland: A Case Study

Over three years before Ansett's collapse there was a noticeable decrease in the Portland traffic, with the average annual load factor rarely reaching more than 30% for arrivals or departures.

The collapse of the Ansett Group saw the termination of all Kendell services, including those to Portland. A service to Portland was resumed in October 2001 as part of the *Rapid Route Recovery Scheme*, as it was perceived as a vital link for the Portland region. The resumed service consisted of two flights per weekday through Portland, however patronage on the route was very poor, with the highest load achieved in October 2001 being only 7 passengers on two occasions only.

Kendell's air service to Portland was operated by the "smallest gauge" aircraft in the Kendell fleet, the Fairchild Metro 23, which with 19 seats offered a capacity well in advance of demand on the route.

Historical passenger data, both before and after the collapse of the Ansett Group, suggests that for a number of years the Kendell service to Portland was financially non-viable, due in most part to the use of an inappropriate aircraft type.



Hamilton and Warrnambool cannot presently sustain services with 19 seat aircraft, even if it were a triangulated service. The major regional airlines do not operate aircraft in the 9 to 12 seat category, nor would they necessarily wish to add this type of aircraft to their fleets.

Measures are therefore needed to encourage small operators with the right "gauge" aircraft to establish services to Hamilton and Warrnambool.



G. REGIONAL AIR SERVICES - INTERCONNECTIVITY

Melbourne Airport is the main international and domestic hub for Victoria. Therefore operations by regional airlines into Melbourne Airport maximise the connectivity for passengers and freight. It is also a regional hub for other destinations both within Victoria and into communities interstate. Regional Express, Southern Airlines and O'Connor Airlines use Melbourne Airport exclusively, whereas Sharp Aviation currently uses Essendon Airport.

The efficiency of this connectivity is a function of the following factors.

Access

Non-turbine aircraft, such as the Piper Navajo, are not speed compatible with jet and turbo-prop aircraft operating into Melbourne Airport and are therefore dissuaded from using the airport during peak periods.

Sharp Aviation therefore needs to operate into Essendon Airport. To optimise Sharp Aviation's future connectivity for passenger interlining, the Commonwealth Government, through Airservices Australia, should consider operating options to allow efficient entry of non-turbine regional airlines to Melbourne Airport during peak periods.

Fees and Charges

Fees and charges at Melbourne Airport are significantly higher than Essendon Airport further dissuading the smaller operator from using the major airport.

Timetabling

Efficient timetabling to allow connection (interlining) with early morning flights and return evening flights is essential.

Congestion

Airspace delays involving prolonged holding due to priorities creates missed connections and potential loss of business.



H. ROLE OF GOVERNMENT(S)

The Commonwealth does not regulate domestic (interstate) or intrastate airline operations.

Fundamentally, the Commonwealth has adopted a policy whereby it is now only responsible for safety regulation. It believes strongly that market forces should dictate the availability and nature of air services to communities.

However, as described earlier, some State Governments still regulate intrastate airline operations, but Victoria has never regulated intrastate airline operations.

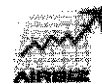
Open market forces have not lead to key rural communities such as Hamilton and Warrnambool maintaining sustainable airline services over the recent decades.

Therefore policies need to be reviewed and measures put into place at Commonwealth and State level to redress this.

Commonwealth Government

It is recommended that the Commonwealth Government:

- Continues the waiver of Airservices Australia en route charges for regional air services (\$6 million in 2002-03)
- Continues subsidy support to Airservices Australia for reasonably priced tower services (\$13 million in 2002-03)
- Introduces an aviation fuel tax rebate for regional airlines
- Facilitates access to soft loans for regional airlines
- Extends flexibility of the Regional Assistance Programme to provide assistance for local governments to undertake economic benefit and feasibility studies into starting air services
- Ensures that the ACCC monitors the commercial behaviour of the two major domestic carriers and Regional Express in any response to small regionally based carrier start-ups on previously unserved routes
- A review of the proposed CASA Part 121B CASR to ensure it does not make it harder for small country based operators to exist



Victorian State Government

The Victorian Government has a major role in facilitating the economic growth of regional communities and access to efficient transport systems. This includes consideration of regional airport infrastructure and potential new or resumed airline services to key regional communities in the state.

It is recommended that the Victorian Government:

- Prepares new legislation to license regional airline operators in Victoria on routes below a set annual passenger threshold in line with the South Australian Government initiative⁴
- Develops a strategic plan for regional airports and air services in the state
- Allocates funds in regional programmes to support feasibility studies and the preparation of business plans by potential start-up airlines for new or expanded routes
- Makes an annual allocation from the Regional Infrastructure Development Fund (RIDF) to support local governments to upgrade airport facilities to support new and existing airline operators where the standard of facilities has declined below acceptable levels
- Reviews its Victoria Tourism Plan to ensure it includes supporting regional air services through stimulation of tourism growth

Local Government

Encouragement

- Local government should provide information to potential airlines on results from potential passenger surveys, business community interest and tourism innovations

Facilitation

- Local government should ensure each regional airport is suitable and attractive for regional airline services, should enter into joint marketing agreements, build and/or facilitate complementary tourism infrastructure developments and continue to stimulate demand through their day to day contact with the broader community

⁴ Government of South Australia, Air Transport (Route Licensing – Passenger Services) Bill 2002



Lobbying

- Local Government should continue to lobby State and Commonwealth Governments in regard to changing policies to enhance regional community access to sustainable airline services and establish partnerships with airlines which commence services

Advocacy

- Local Government should actively build alliances with other regional communities with airports to lobby as a block for changed policies or introduction of new measures to lower barriers to entry and mitigate risks for new small airline operators

Co-ordination

- Local Government should work through Area Consultative Committees (ACC) to continue to research airline opportunities and monitor the on-going health of airline start-ups



I. REGIONAL SERVICES – THE ROLE OF MAJOR AIR TRANSPORT CARRIERS

Qantas, as the only remaining large carrier group, in its 1999 submission to the H.O.R Inquiry into Infrastructure and the Development of Australia's Regional Areas, claims that the scale of the group generates benefits for regional passengers, and by extension to regional communities, through:

- International marketing and distribution networks
- Global computerised reservations systems linking regional centres to the world's travel industry
- Frequent flyer programs
- Lounge facilities
- Reciprocal benefits with other carriers in the same alliance group (Oneworld)

However it is questionable whether these are the benefits that are genuinely wanted and valued by residents and businesses in regional areas. Much of the so-called benefits that Qantas espouses are the "product" of traditional large international and domestic carriers with high featured, multi-class product offerings, underpinned by expensive legacy information systems.

Experience around the world suggests that major air transport carriers do not necessarily provide the best solution for regional communities.

The reason for this is manifold. Core business principals suggest that the larger the business, particularly if the company is operating internationally, domestically and regionally, the less attention will be given to lower revenue producing activities.

Fleet mix is a financial issue for airlines. A homogeneous fleet, being ideally one manufacturer and say an all jet or prop fleet, is the most efficient in regard to deployment of resources for maintenance, training and operations.

Regional operations by these airlines are at best carried out by regional subsidiaries but the experience in Victoria (e.g. Kendell) has been that such airlines have used turboprop aircraft with an inappropriate capacity (e.g. 19 seats) on thin routes that do not support such capacity.

Regional Express is maintaining operations to Portland, once again with 19 seat aircraft with a mixture of direct and triangulated services. An airline operating smaller capacity aircraft may be able to provide direct and higher frequency services to this community.

It is concluded that major airlines do not have a positive role in developing regional airline services on thin routes and that government measures are required to encourage small operators to enter this market to benefit regional communities such as Hamilton and Warrnambool.