

REGULATION OF AIR TRANSPORT IN NSW PUBLIC CONSULTATION

COMMENTS BY REGIONAL EXPRESS

Regional Express Holdings Limited (Rex) is the listed entity which owns two regional airlines operating intra New South Wales scheduled services – Regional Express (Rex) and Air Link. It also has a charter and freight subsidiary Pel – Air Aviation which operates contracted air freight services to regional centres as well as passenger and freight charter services.

Rex is Australia's largest independent regional airline and the largest regional airline operating services intra New South Wales. Rex operates thirteen Saab 340 aircraft between Sydney and fifteen regional centres on some 550 flights weekly. Air Link operates two Beech B1900D, five Piper Chieftain and three Cessna 310R aircraft on services linking Sydney with eight regional communities some via a hub in Dubbo.

In New South Wales, Rex operates services on four competitive, unregulated routes as well as being the licensed sole operator on eleven routes. Air Link operates on one competitive unregulated route and is the licensed sole operator on seven intrastate routes.

The comments in this response cover the views of both Rex and Air Link.

Rex has been very successful in developing all of the route markets on its network achieving substantial passenger growth on the back of a significant reduction in average fares. The average fare on the Rex network today is 40 percent below that which applied four years ago. Even adding in the fuel surcharge necessary to alleviate the impact of spiralling fuel prices (which only recently reduced by \$3.00 to \$24.00 per sector) Rex's average fares are 20 percent below the levels which applied four years ago. Rex's average fare excluding taxes and charges and the fuel surcharge is \$100 per sector across the network.

Rex's strategy of providing very affordable fares through increased productivity and containment of costs coupled with investment in aircraft providing increases in seating capacity from additional flight frequency and upgrading services from 19 seat Metro 23 aircraft to 34 seat Saab 340 aircraft (Rex does not operate Metro aircraft in regional airline services anymore), has resulted in passenger carriage on the Rex network achieving all time records. This approach, including the fare structure and general fare levels, is applied to all routes on the Rex network across all States regardless of the application of licences or the existence of competition from another operator.

The table below sets out Rex (not including Air Link sole routes) operations in New South Wales as well as some comparisons with other non- Rex routes in the State.

Route - to/from Sydney	Market Nature	Operator	Total Annual Pax (Oct 2005-Sep 2006)	Rex Annual Pax (Oct 2005 - Sep 2006)	% Growth since 2002 (Jan-Dec)
Cooma	Sole Operator	Rex	15,765	15,765	282%
Parkes	Sole Operator	Rex	30,184	30,184	195%
Merimbula	Sole Operator	Rex	35,636	35,636	149%
Narrandera	Sole Operator	Rex	15,450	15,450	115%
Griffith	Sole Operator	Rex	61,556	61,556	114%
Lismore	Sole Operator	Rex	65,447	65,447	112%
Moruya	Sole Operator	Rex	14,833	14,833	108%
Bathurst	Sole Operator	Rex	22,113	22,113	75%
Orange	Sole Operator	Rex	57,182	57,182	64%
Broken Hill	Sole Operator	Rex	13,744	13,744	26%
West Wyalong	Sole Operator	Rex	4,706	4,706	N/A
Ballina	Competitive	Jetstar, Rex, Virgin Blue	280,449	58,015	301%
Wagga Wagga	Competitive	Qantas, Rex	150,148	68,207	65%
Albury	Competitive	Qantas, Rex	150,721	58,558	54%
Dubbo	Competitive	Air Link, Qantas, Rex	156,911	53,195	63%
Port Macquarie	Sole Operator	Qantas	103,019		43%
Tamworth	Sole Operator	Qantas	90,509		38%
Lord Howe Island	Sole Operator	Qantas	27,289		24%
Moree	Sole Operator	Qantas	21,180		14%
Narrabri	Sole Operator	Qantas	11,932		10%

Clearly the growth in passengers achieved on Rex sole operator routes and Rex competitive routes outstrip those where other sole operators serve the markets.

LICENSING AND COMPETITION POLICY

Generally, the current policy of restricting competition to certain routes with annual passenger carriage below 50,000 has had the intended objectives and assumptions of:

- ensuring that smaller communities will be able to have an air service by providing a sheltered competitive environment to entice airlines to start or maintain services;
- passenger throughput of above 50,000 pa would be sufficient to enable two or more competitive airlines to survive

ACTUAL ENVIRONMENT FOR REGIONAL AIR SERVICES

While the current policy has provided a level of stability in smaller markets, it has not guaranteed services to communities nor any guarantee that airlines will survive.

Regional Air Services Are Not Economically Viable

The harsh reality is that regional air services are becoming less and less viable. Increasing costs of regulation and compliance, higher operating costs and the impact of severe economic conditions flowing from the drought make it increasingly more difficult for small regional airlines to survive. Economies of scale and the lowering of unit costs has been the manner in which Rex has been able to survive and grow.

Licensing Does Not Ensure Viability or a Service

Over the period of the current licence term a number of operators have failed, communities have lost services and other operators entered markets in some cases providing vastly inferior levels of service. During this period Impulse, Horizon, Macair, Sunshine Express and now Big Sky Express have ceased services in New South Wales. Apart from Rex and Brindabella Airlines, no new airlines commenced services in New South Wales.

Deregulation of a Route Does Not Necessarily Lead to Competition

Experience has also shown that the ability to provide competitive services on routes with passenger carriage above 50,000 annually also does not guarantee competition. There are markets with annual passenger carriage above this level which retain one operator – such as Tamworth and Port Macquarie. Others such as Orange, Griffith and Lismore on the Rex network, which are sole operator licensed routes, have now grown to enjoy annual passenger carriage well in excess of the 50,000 limit. While they remain licensed at present, removal of the restriction is unlikely to result in competition in the current environment.

There is actual evidence to support the premise that a regional market size in excess of 50,000 per annum cannot support viable competitive services from two operators of larger turbo-prop aircraft in the 30 to 50 seat range as operated by Rex and QantasLink.

For example, Rex entered the Sydney – Armidale route in competition with QantasLink in September 2004 when the annual passenger market was around 60,000. With Rex's entry and a significant reduction in the market average fare paid by travellers on the route (from around \$200 per sector to around \$120 per sector)

annual passenger carriage grew rapidly to in excess of 90,000 per annum. However, the reduced yield and overall passenger demand was not sufficient for Rex to cover its costs. Given Rex could not see sustained improvements in either the average fare or passenger demand, Rex withdrew services in July 2006. The Armidale market is again seeing reduced passenger carriage and higher average fares.

Similarly, in markets elsewhere in Australia where competition is open, QantasLink has withdrawn from Melbourne – Burnie and Adelaide Port Lincoln where annual passenger carriage for the total market exceeded 120,000. Rex also withdrew from the Melbourne – Devonport competitive market in 2004 where again the total annual passenger carriage was just in excess of 100,000. Rex aims to carry in excess of 160,000 passengers annually on Port Lincoln and 150,000 passengers on Burnie as a sole operator on unregulated routes. Frequency of flights, convenient schedules and very affordable fares with 34 seat aircraft is achieving this outcome.

This experience in unregulated markets indicates clearly that markets with annual passenger carriage below 100,000 struggle to sustain competitive operations by airlines with 30 to 50 seat aircraft.

The applicability of the 50,000 annual passenger threshold for competitive services is therefore questioned and given actual experience, is effectively irrelevant. Lowering the threshold to 35,000 or raising it to 65,000 is also considered to make little difference.

However, maintaining a single licensed operator for routes above 50,000 annual passengers provides the potential for an operator to inhibit market growth through higher average fares with the protection of the single licence (refer to the low passenger growth on Tamworth. Port Macquarie and Moree / Narrabri in the Table above).

Rex submits that placing an arbitrarily determined threshold of annual passenger carriage on a route under which a sole route licence is issued has the potential for detrimental affects on passenger growth, route development and average fare paid.

REX'S POSITION

Given the harsh economic realities facing regional air services today, Rex is of the view that the rationale and approach to licensing is not appropriate. Services which are not commercially viable will not be sustainable just because of the presence of licensing protection. Conversely, Rex believes there will not be a rush of competition just because a licence restriction has been removed.

Licensing produces distortions and rigidities that neither benefit the community nor the industry as whole. Hence even though Rex is the biggest beneficiary of sole operator route licenses in New South Wales and is contemplating applying for additional routes in the next round, we are of the view that licensing in New South Wales should, as a general approach, be phased out altogether.

On this basis, Rex recommends that all current licence holders be advised that all licensing will cease and that current licences will be given one ultimate extension of two years to help in the transition process.

COMMUNITY SERVICE

Rex recognises the vital importance viable and effective air services are for regional communities. In many cases Rex has entered into partnership agreements with local councils who own and operate regional airports to co-invest in the service and develop it to its full potential.

Such partnerships include reduced overall passenger charges levied by the airport coupled with a larger contribution from Rex to reduce lead-in and deep discount air fares to levels which generate passenger demand and growth. Other partnerships include incentives involving reduced passenger charges over certain agreed thresholds thereby reducing unit costs providing the ability to offer deep discount lead-in fares to generate demand.

In recognition of the success of these partnerships and the significant co-investment in building the service by the local community and the airline, Rex recommends that while all routes should be subject to competition, the local community should have the right to enter into such arrangements as they see fit.

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