Submission No 57

INQUIRY INTO REGIONAL AVIATION SERVICES

Organisation: Rex Regional Express

Date received: 21/03/2014

Regional Express Submission to the

NSW Legislative Council

Inquiry into NSW Regional Aviation Services

March 2014

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1 PREAMBLE

Regional Express (Rex) welcomes the opportunity to provide a submission to the Legislative Council Standing Committee on State Development on the provision of regular passenger (RPT) air services to regional centres in New South Wales.

In addition to the provision of essential Regional air services through the State of NSW the Rex Group of companies are a significant contributor to the NSW economy. The Rex Group comprises of Regional Express (Rex), Air Link, Pel-Air and the Australian Airline Pilot Academy (AAPA).

The Rex Group employs some 1077 staff, with Rex accounting for more than 80% of the Rex Group total workforce. The Rex Group employs 697 staff in NSW, of which 257 are based in regional NSW and this excludes an additional 160 staff employed by the contracted Rex ground handling agents located in the 17 NSW regional ports serviced by Rex.

Wagga Wagga represents the largest pool of Rex Group NSW regional employees with 163 staff employed by Rex and AAPA and an additional 22 staff are based in Rex's Customer Contact Centre located in Orange. In addition Rex has regional NSW flight crew bases in Albury, Dubbo, Lismore, Orange and Wagga Wagga. Air Link also employs 13 staff at its base in Dubbo.

Since 2008 the Rex Group has invested some $30M in pilot training, with the establishment of the Australian Airline Pilot Academy (AAPA) based in Wagga Wagga. The AAPA facilities include a fully self contained campus catering for up 100 pilot students and the academy has 16 Piper Warrior and 4 Piper Seminole training aircraft. AAPA facilitates the Rex cadet program for Rex, in addition to other pilot training for domestic and international customers.

In addition to the significant Rex Group investment associated with pilot training, Rex continues to re-invest in its airline operations to improve efficiencies and to help offset the core inefficiencies associated with operating a regional airline on thin and marginal routes. This re-investment also helps to partially shelter Rex from downturns in the aviation industry such as what the industry is currently experiencing now. In the current FY14 this re-investment has included the purchase of Saab 340 aircraft at the end of lease, acquiring a significant holding of Saab 340 spares, and the purchase of a full motion Saab 340 simulator and construction of a purpose built Saab 340 simulator centre at AAPA in Wagga Wagga. Having a profitable business is essential in ensuring that such significant investment can be undertaken as the smaller independent regional airlines don't have the deep pockets of the larger network carriers.

In mid 2013, Aviation Week and Space Technology ranked Rex as the Top Performing Airline in the Asia-Pacific region and second for all carriers worldwide, in a study based on performance categories covering liquidity, financial health, earnings performance, fuel management and capital efficiency over the 2012 calendar year. This result is a continuation of Rex's solid performance in previous years, where since 2009 Rex was ranked as the world's top performing regional airline, a category which no longer exists as of the 2013 rankings.

Rex understands the importance of having reliable services and in 2013 Rex was ranked the top performing Australian airline by the Federal Government's BITRE with departure on-time-performance of 86.9% and a low average cancellation rate of 0.6% that was only bettered by the Skywest West Australian only operations.

Airline	2013 On Time Departure rate	2013 Cancellation rate
rex. Regional Express	1st (86.9%)	2nd (0.6%)
QANTASLINK	4th (79.5%)	7th (2.7%)
QANTAS	2nd (85.5%)	3rd (1.5%)
Jet	8th (75,0%)	6th (1.9%)
Virgin australia	3rd (79.6%)	4th (1.6%)
Virgin australia ATR Operations	5th (78.1%)	8th (3.8%)
Skywest	6th (77.5%)	1st (0.2%)
tiger airways.com	7th (76.6%)	5th (1.8%)

Despite the operational challenges associated with operating services to/from Sydney, Australia's busiest airport Sydney, Rex achieved 83.3% departure on-time-performance for all of its services to/from Sydney airport in 2013 and a cancellation rate of 0.7% with the majority of cancellations being associated with winter due to fog and bad weather. This is a good result given the airport traffic congestion and due to the operating conditions that are imposed upon Rex. At Sydney airport Rex operates 20 Saab 340 aircraft with annual passenger throughput of more than half a million and this is facilitated through a single departure and arrival gate, with remote aircraft parking and subsequent bus transfers (at Rex's cost) between the airport terminal and the aircraft.

In addition to Rex's focus on service reliability, Rex is mindful of the tremendous social and economic impact its services have on the regional communities and strives to work in partnerships with these communities to balance their needs against the imperatives of providing a sustainable regional air service.

Rex is also committed to giving back to regional communities by supporting worthy charitable causes which are focused on helping those in need. Typically Rex commits around a quarter of a million dollars annual to such causes and in the first half of FY14 Rex contributed over $111K to various worthy causes ranging from fundraisers to important community events.

In December 2013, Rex was voted by the Australian Traveller Readers' Choice Awards Survey as the "Best Australian Regional Airline" for the second time ahead of Qantas and Virgin. Rex won the same category in 2011, the Awards' inaugural year, and was a finalist in 2012.

2 BACKGROUND – REX REGULAR PUBLIC TRANSPORT (RPT)

Rex commenced operations in August 2002 as the merger of 2 subsidiaries, Kendell and Hazelton Airlines, of the now-defunct Ansett Airlines. Listed on the Australian Stock Exchange (ASX) in 2005, Rex is Australia's largest independent regional airline operating a fleet of 48 Saab 340 aircraft out of Sydney, Melbourne, Adelaide and Townsville hubs to regional centres.

Rex carries some 1.1 million passengers annually across 65,000 sectors to 36 destinations.

Rex currently services the following NSW *intrastate* services;

From	To	Serviced by	NSW Regulated
Sydney	Albury	Rex, VA, QF	No
Sydney	Armidale*	Rex, QF	No
Sydney	Bathurst (RR)	Rex	Yes
Sydney	Ballina/Byron Bay	Rex, JQ, VA	No
Sydney	Broken Hill (RR)	Rex	Yes
Broken Hill	Dubbo	Rex	No
Sydney	Grafton (RR)	Rex	Yes
Sydney	Griffith	Rex	No
Sydney	Lismore	Rex	No
Sydney	Merimbula (RR)	Rex	Yes
Sydney	Moruya (RR)	Rex	Yes
Sydney	Narrandera (RR)	Rex	Yes
Sydney	Newcastle	Rex	No
Newcastle	Ballina/Byron Bay	Rex	No
Sydney	Orange	Rex	No
Sydney	Parkes (RR)	Rex	Yes
Sydney	Taree (RR)	Rex	Yes
Sydney	Wagga	Rex, QF	No

* Armidale - Rex commence 28 March 2014
VA - Virgin Australia, JQ - Jestar, QF - QantasLink
(RR) -NSW Regulated Route

In 2013 CY, Rex carried 500,000 annual passengers on the above mentioned NSW *intrastate* routes. Of the 500,000 annual passengers, only 150,000 passengers were associated with the 8 NSW regulated routes (RR). It is also important to note that the “total” market size of the above 5 mentioned “competitive” routes is approximately 1,000,000 passengers.

1. Rex currently operates the following NSW *interstate* services;

From	To	Serviced by
Albury	Melbourne	Rex
Broken Hill	Adelaide	Rex
Broken Hill	Mildura*	Rex
Merimbula	Melbourne	Rex
Sydney	Mildura	Rex
Wagga Wagga	Melbourne	Rex

* Connects to Melbourne with Rex

In 2013 CY, Rex carried some 100,000 annual passengers on the above mentioned NSW interstate routes. These are important regional interstate air services that provide significant benefits to the State of NSW and to the specific regions.

3 Major Threats to NSW Regional Aviation Services

3.1 Access to Sydney airport

Continued access to Sydney Kingsford Smith Airport (KSA) is critical to the sustainable provision of NSW regional air services due to the essential nature of regional air travel. Regional communities depend upon on a reliable and sustainable regional air service for medical, business and government related travel. It is crucial to the socio-economic fabric of regional communities and the benefits are far reaching across local, state and federal government levels.

There are several key issues with regards to regional NSW access to Sydney airport.

- Airport Slot Availability
- Airport Pricing
- Airport Non-Pricing Pressure Points

3.1.1 Airport Slot Availability

Under current Federal Government policy, there are two key regulatory safety-nets for regional air services at Sydney Airport that recognise Sydney airports role as an essential transport hub for regional NSW. The first is the legislated protection of NSW regional slots at Sydney airport.

The ring-fence protection of NSW regional slots formed part of the important legislative arrangements prior to the sale / privatisation of Sydney airport in 2002. The ring-fence protection of NSW regional slots was a result of the strong commitment of both Coalition and Labor Governments to ensure that regional NSW continue to have guaranteed access to air regional air services at Sydney airport and this important measure is enshrined in legislation.

Sydney airport tendered for the purchase of the airport on the basis of NSW regional slots being protected and would have accordingly reflected the legislated needs of regional NSW in their tender price.

Importantly, under the slots compliance scheme, all airlines have to comply with strict 'use-it-or-lose-it' provisions in order to maintain usage of the slots and this is equally applicable to the regional airlines operating with protected NSW slots. These historic precedence provisions require regional airlines to use at least 80% of their NSW regional slots in any given schedule period, otherwise the slots will be returned to the regional slot pool for alternate NSW intrastate regional usage. It has been demonstrated that demand for NSW regional slots has been maintained between 2002 and 2014, as evidenced by the NSW regional slot pool being fully allocated in the legislated peak periods (6.00am – 11.00am and 3.00pm until 8.00pm) of operation at Sydney airport.

It is important to point out that the regional slots "belong" to the regional carrier subject to the historic precedence provisions and do not belong to the regional cities for which the slots are allocated. A carrier could redeploy its slots from one regional city to another without losing precedence.

Under the Sydney Airport Demand Management Act, Sydney airport is also constrained by the arbitrary movement cap of 80 movements per hour. This arbitrary restriction was implemented 17 years ago in 1997, with only minor regulatory reform being applied during this period.

The arbitrary cap of 80 aircraft movements per hour does not reflect the actual capacity of Sydney airport which is around 90 movements. In addition, the compliance regime that enforces the 80 movement cap is excessive in that it assesses the cap against rolling 15 minute quarters. (i.e. 0800-0900, 0815-0915, 0830-0930 etc.) This compliance regime exceeds any practical requirements given the airport rarely hits the cap.

The nature of aviation means that disruptions are inherent, particularly due to weather in Sydney or up-line weather at other ports (particular regional NSW) and the arbitrary movement cap hampers Sydney airports ability to respond accordingly, triggering consequential flight delays across the country, including to regional NSW

The excessive compliance of the movement cap also sees the situation whereby departing aircraft can be held at Sydney airport until a new 15 minute quarter is passed. This mainly occurs when Airservices are attempting to clear a backlog of flights following unforeseen weather events such as fog or other events of Mother Nature.

It defies logic that departing aircraft can be held at Sydney airport to keep aircraft movements below an arbitrary movement cap, when this is compounding airport congestion, increasing airline costs and making the airport less efficient. This is not to mention the subsequent increased carbon emissions that the airlines are subsequently taxed for via the imposition of the carbon tax that is applied to the airlines fuel burn. There is also the significant impact to airline on-time-performance and consequential impacts to other airports across the country, including regional NSW.

In respect to the compliance of the movement cap, it should be sufficient to enforce the cap solely through the advance allocation (i.e. planned movements) of the slots to the airlines. It should not matter if the movement cap is operationally exceeded on the day of departure in the interest of maximising aircraft movements and airport efficiencies. Airports implement Runway Demand Management Systems (Slots Systems) to maximise airport efficiencies, not make them less efficient, and there is no practical difference if there were 79 movements in one hour and 81 movements in the next hour when it comes to the issue of aircraft noise, with noise being the core driver of the movement cap.

3.1.2 Airport Pricing

The second regulatory protection mechanism is the Federal Governments Declaration under the Competition and Consumer Act 2010 that ensures that any increases to core Sydney airport pricing for regional airlines is capped at CPI and must be submitted to the ACCC for scrutiny.

Like the ring-fence protection of NSW regional slots, the Sydney airport pricing protection for regional airlines was also enacted in 2002 as part of the Sydney airport sales Act.

In mid 2013, the Federal Government issued a new Declaration under the Competition and Consumer Act and this seen the continuation of the established access and reasonable pricing arrangements for regional airlines at Sydney Airport. This extends the regime that commenced in 2002 for a further three years, through until 30 June 2016.

The Government Declaration means that any increases to the core Sydney airport pricing applicable to regional airlines has to be notified to and assessed by the ACCC. In assessing any such notified price increases the ACCC must have regard to the Direction which requires that Sydney airport price increases relating to regional air services should not exceed the percentage increase in the Consumer Price Index (CPI).

The value of this ACCC oversight was proven in 2010.

In 2010, Sydney airport sought to impose massive and unjustified price increases on Rex. The original price increase proposal by Sydney airport in March 2010 would have seen the charges payable by Rex rise from $70,000 per annum to $5.7M per annum. Sydney airport subsequently revised its initial proposal to one which would see Rex having to pay over $3M per annum in additional charges. No independent regional carrier could afford to use Sydney Airport if it had to pay such massive charges.

At the time Sydney airport was attempting to re-classify its charges to regional airlines so as to avoid having to notify the ACCC and disclose the magnitude of its proposed increases. Rex tabled this with the ACCC and the ACCC issued a stern public warning to Sydney airport who agreed not to increase charges to regional airlines outside the Part VIIA notification process.

Sydney airport then submitted a notification to the ACCC in June 2010 for a 2.9% passenger head tax increase. This proposal would have made Rex pay an additional $130,000 per annum to Sydney airport. The ACCC assessed the proposal and required Sydney airport to provide evidence to support its asserted justifications for the 2.9% price increase, which Sydney did not produce to the ACCC. The ACCC therefore objected to the increase in September 2010, essentially due to the total airport revenue growth applicable to regional airlines had grown well in excess of CPI, despite the head tax unit rate remaining unchanged.

The outcome of the regulatory safety net was that Sydney airport dropped the proposal.

Without the Declaration and Direction, Rex would have been priced out of Sydney Airport in 2010. If the current Declaration and Direction had not been extended in mid 2013 through until mid 2016, then there would have been nothing to stop Sydney airport from pricing independent regional operators out of Sydney Airport after 1 July 2013 with a consequent loss of regional services for New South Wales.

The 2009 Aviation White Paper recognised Sydney Airport's role as an essential transport hub for regional New South Wales and expresses the clear policy:

"The Government will also ensure regional airlines' continued access to capital city airports, particularly Sydney where capacity is constrained, by retaining regional airlines' existing access slots and their current pricing arrangements."

This is detailed further in the 2009 Aviation White paper at pages 14-15:

"In recognition of the challenges facing the industry and the communities that rely on regular air services the Government will improve support for regional and remote communities dependent on air services by; ….. continuing with the current regulatory regime which caps pricing for regional airline aeronautical charges at Sydney Airport to CPI levels"

and also at pages 58- 59:

"The Government recognises Sydney Airport's role as an essential transport hub for regional New South Wales and will ensure access and reasonable pricing for regional airlines. This will be done through a combination of: …. maintaining slots held by regional airlines at Sydney Airport, including during peak periods, at levels available in 2000, prior to privatisation; and … capping airport charges for regional airlines – these charges may not be increased by more than the annual Consumer Price Index."

3.1.3 Airport Non-Pricing Pressure Points

The regulatory safety net for the ring-fence protection of NSW regional slots and the Sydney airport core pricing arrangements are critical regulatory protection however more protection measures are required.

Whilst the Sydney airport pricing protection for regional airlines covers the core aeronautical pricing arrangements, there are many areas that are not covered by this regulatory protection.

For example, an airline has a broad range of infrastructure requirements at a capital city airport. This includes hangar space to undertake necessary aircraft maintenance, office space for staff including airport staff and flight crew, ground support equipment storage areas, check-in desks and customer waiting areas, including airline lounges. There are all mandatory requirements for a regional airline to operate, yet they are not covered by any regulatory protection.

These leaves the smaller independent regional airlines highly exposed to both price increases associated with mandatory airport requirements and airport decision making that can lead to a significant negative impact to the airline and its customers. What maximises profitability for the airport may make an airline less efficient or add cost or reduce the quality of service and quite often all three of these outcomes are incurred.

Without regulatory oversight there is no 'check and balance'.

For example, the regional airlines arrivals area could be relocated requiring a greater walk for regional customers, inadequate access to ground transport and an inability to connect with other regional, domestic and international services. This has a commercial impact to the airline which is a real cost and in addition the airline incurs inefficiencies and additional staffing costs.

The airlines aircraft could also be directed to park in an area that is further away from the passenger terminal due to the prioritisation of larger aircraft. In the case of Sydney this requires additional bussing time (additional bussing cost of about $800,000 a year for Rex) between the terminal and the aircraft with a consequential negative impact to on-time-performance due to the further distances and the busses having to cross live taxiways and hold for departing and arriving aircraft. The airport does not offer any compensation for the deterioration of service levels, lost efficiencies and additional airline operating costs and in fact the airport attempts to impose additional aircraft parking charges due to the aircraft being directed to park in a General Aviation area.

3.1.4 Recommendations

- Maintain the Federal Government ring-fence protection of NSW regional slots

- Maintain the Federal Government core airport pricing regulation via the Government Direction under the Competition and Consumer Act 2010

- Widen the scope of the Federal Government Direction to protect regional airlines from airport non-pricing pressure points and pricing pressure points that are not covered by the Direction 'or' appoint a third party ombudsman to adjudicate on Sydney airport negotiations (all Capital City airports) with regional airlines.

- Increase the Sydney airport movement cap to 90. As an alternative remove the NSW regional slots from the Sydney movement cap due to the regional turboprop aircraft being quieter than the larger jet aircraft.

- Remove the excessive movement cap compliance regime (rolling window period of 15 mins) and administer the movement cap via the advanced allocation of movements (slots) not exceeding the defined cap.

3.2 Regional councils/airports monopolistic behaviour

Rex operates to 33 regional airports across Australia, with the vast majority being owned by local councils. Regional airports were vested the local councils at no cost (often with a large sum to offset future maintenance costs) by the Federal Government prior to 1991. Regional airports are a vital piece of community infrastructure and form a valuable community asset.

Regional airports should be treated no differently than local roads and bridges as critical local infrastructure that has broad ranging benefits across the entire council municipalities. Yet, most regional airports adopt a user pays approach that requires the 'airport business' to stand-alone at no cost to the council ratepayer and in many cases generate a substantial surplus back to council.

Rex sees three main areas of concern in regards to regional airport monopolistic behaviour;

1. Generation of excessive revenue surplus via the airport head tax revenue stream.
2. Building of grandiose airport terminals that exceed the current and forecast requirements of the airport.
3. Expansion of runways, taxiways and apron to cater for larger jet aircraft that exceed the current and future requirements of the airport.

The 'built it and they will come' approach comes with extremely high risk. Developing regional airports should be undertaken with a phased and rational approach and questions do need to be asked when some regional airports embark on such plans (to accommodate wide-body jets such as A320 and 737) when the regional airports current and forecast demand can be readily accommodated with turbo-prop aircraft that don't require the massive infrastructure spend.

Many regional airports have not placed any revenues into necessary sinking funds for the major capital investment that will be required in maintaining and upgrading airport infrastructure and years later seek to recoup this mismanagement through increasing airport charges to the detriment of regional airlines and regional customers.

Regional airports are dynamic with ever changing passenger through-put and activity levels. In a competitive environment, regional airports should consider passenger and activity growth (and subsequent improved airport efficiencies) rather than simply applying routine CPI increases. Few council's seem to want to acknowledge the simple logic that it is head tax revenue growth that is important and not head tax rate growth.

If the regional airport passengers have doubled and airport revenue has subsequently doubled, then it defies economic logic for a regional airport to state that its charges have not increased for a number of years and that this therefore represents a "fee reduction in real terms". What the regional airport should be doing is sharing the improved airport efficiencies and economies of scale by reducing the airport unit rate charges in order to assist with air service viability and affordability of fares to the benefit of their local community. However most councils adopt the view that any reduction in unit rate costs is deemed a subsidy or a rebate “at the expense of the ratepayer” and this is not correct when airport revenues are still incrementally growing in most cases by much higher rate than CPI.

Too often the commentary about regional airport charges is steered towards the larger volume regional airports, which in Rex’s NSW network includes Albury, Dubbo and Wagga. Rex has lost count of the times that the ‘BITRE publication Avline 2010-11’ has been quoted back to Rex by regional airports, due to the said report highlighting that a number of higher volume regional airports (including Albury, Armidale, Dubbo, Port Macquarie, Tamworth and Wagga Wagga in NSW) have seen their airport charges remain unchanged in nominal terms and fall “in real terms”.

What is not referenced is that the airports revenue has increased in the absence of no increases to unit rate charges due to increased passenger numbers. The unit rate that is charged is irrelevant as it is the airport revenue that matters.

Albury airport generated around $1.4M from RPT passenger in FY03, which increased to approximately **$3.9M** (incl. GST) in FY13 which is around 11% annual airport revenue growth. Rex acknowledges that that Albury City Council has spent more than $10M in recent years to upgrade the airport and has future plans to overlay the runway for a further $2.6M. However the works are primarily required for the larger and heavier aircraft operated by Virgin Australia and QantasLink, yet Rex’s Albury passenger head tax costs (FY13) remained at around $1M which is more airport revenue than any of the Rex sole operator airports in NSW.

Dubbo airport generated around $1M from RPT passenger taxes in FY03, which increased to approximately **$2M** (incl. GST) in FY13 which is around 7% annual airport revenue growth. Dubbo airport has also spent close to $10M on airport works in the past 12 years and has more than this amount forecast to spend through until FY22. Rex’s requirements are no different in Dubbo to what they are in Parkes (just down the road) yet Parkes airport earns around $250K per year in airport charges.

Dubbo council has proposed a 2.7% head tax increase for FY15 that represents an additional cost to airlines of around $50K per year. This is despite the Dubbo airport business plan for FY15 forecasting that Dubbo airport will contribute a surplus of $295K to council rates and general revenue. The total capital expenditure at Dubbo airport in the next 10 years is expected to be around $17M which includes a runway extension (that has required acquisition of land approved by council in 2013) to enable wide body jet operations up to Airbus A320-200 and Boeing 737-800 equivalent. Whilst Rex supports long term airport planning it must be rational and in accordance with the needs of the market. The Dubbo to Sydney market of approximately 170K annual passenger is already more than adequately serviced with more than 310,000 total annual seats on the route.

It should be noted that it costs no more than $500,000 to efficiently run a regional airport.

The contrast could not be more stark between the regional airports who truly value their regional air service and those that chose to embark on grand plans based on the 'build it and they will come" approach.

Parkes is a great example of a collaborative partnership between the airline and the local council. Rex, in partnership with Parkes Shire Council has grown the Parkes to Sydney passenger numbers from around 12,000 to 30,000 per year since FY03. This involved setting passenger thresholds that, once exceeded, result in a lower airport passenger tax. During the important building years that required significant Rex investment and commercial risk, the partnership arrangements provided Rex with the necessary incentive to undertake a longer term approach to grow the market that would not have possible in the absence of such collaboration. This enabled Rex to transition the Parkes to Sydney route with from a 19 seat aircraft to a 34 seat aircraft , triggering increased capacity, improved flight schedules and more affordable fares achieved through improved efficiencies and lower unit costs. At the same time, Parkes airport revenue continues to grow and more importantly the Parkes Shire benefits from the tremendous social and economic benefits that flow from the improved air service.

When Parkes airport and Orange airport are compared, both are serviced by Rex as the sole operator with Parkes airport receiving 3 return Saab 340 services each week day and Orange airport receiving 4 return Saab 340 services each week day. It does not make sense that Rex is charged more than 300% more to operate to Orange than Parkes, with both airports having similar operating costs.

Orange airport has the most expensive passenger head tax rate across the entire Rex network ($15.95 incl. GST) and Rex stands by its recent opposition to Orange City councils proposed head tax increases. The most recent proposed head tax increase by Orange council was communicated to Rex on 6 December 2013 and this was decided upon by council within days of Brindabella airlines announcing their withdrawal from the Orange to Sydney route. It was also only weeks prior to the collapse of Brindabella. Orange council was not being paid by Brindabella airlines and yet it was attempting to increase the charges applicable to Rex, an airline who has serviced the Orange to Sydney route for multiple decades (with predecessor Hazelton Airlines) and that has always paid its airport charges in a timely manner. This action is totally irresponsible from Orange council. The decision to increase the head tax was put on hold by council following Rex's opposition.

Orange airport is choosing to embark upon grand plans to build a new terminal, extend the runway and upgrade the apron and taxiways at a total cost of some $19M. Orange airport has annual passenger through-put of around 55,000 passengers and Rex is the sole RPT operator providing services to Sydney with its 34 seat Saab 340 aircraft. The new Orange airport terminal has planned seating for 240 passengers, which is some 7 times the seating capacity of the aircraft servicing Orange.

Orange council communicates that the airport upgrade is to cater for new aircraft technology and to cater for increased passenger numbers. Council also quotes the additional benefits of 'potential extra passenger flights' and 'increased opportunities for additional charter services' as justifications for the upgrade. In the business world this is not sufficient justification to warrant such a significant spend, particularly in the current toxic aviation climate. It is the airlines and their customers that generate the demand, not the airport and the airports need to cater for the demand.

Far from realising its pipe dream, Orange may face losing some of its Rex flights as the demand is deteriorating.

In addition federal taxpayers are contributing around $4.9M in funding grants to the Orange airport upgrade. In contrast, there are many smaller regional airports that are deserving of government funding for basic and essential works which have not been able to access funds. Coober Pedy airport in South Australia recently had airport funding denied due to an essential requirement to widen the runway to meet CASA regulatory changes and such funding was denied. Without the widening of the runway there is the real potential of no RPT operator being able to service Coober Pedy airport.

A further example of regional airport monopolistic behaviour is at Mount Gambier airport in South Australia, which also follows a similar 'build it and they will come' philosophy.

Mount Gambier airport (owned by the District Council of Grant) unilaterally imposed a hefty 46% passenger head tax increase on to Rex during FY11, which followed subsequent increases of 9% and 8% during FY09 and such unjustified increases in the passenger tax (in spite of the fact that airport revenues had grown significantly because of the increased throughput of Rex passengers) have a significant impact on ticket pricing and a subsequent impact to passenger demand.

In 2010, at the time of the 46% head tax increase, the District Council of Grant communicated that the unilaterally decided increase was necessary "to cater for charter planes and lager aircraft like QantasLink which presently cannot land here" and that "Port Lincoln (SA) already has QantasLink and as a regional airport we also deserve to have this ability".

Rex warned the District Council of the predicted outcomes, stating that;

"the council's actions were economical economically and socially irresponsible as the community will end up paying for the additional costs through higher ticket prices. This will have a negative downward spiral effect as higher fares will mean fewer passengers which in turn will translate into a reduction of services which in turn will lead to a further reduction of passengers" and "*In the not too distant future the District Council will have to explain to the community why it had spent millions on additional airport infrastructure to welcome an ever decreasing number of passengers"*

Councils and airport owners always take the simplistic view that their increase is only the cost of a cup of coffee which the airline could easily pass on to passengers. The case of Mount Gambier is a good illustration of the devastating effect of this "cup of coffee".

For the period FY09 to FY13:

- passenger numbers have dropped by 18,000 a year, or 18%, a not insignificant amount for a small regional town;
- Rex's annual revenue has increased by only 2% per year;
- Council's annual head tax revenue has increased by 33%
- ticket prices have gone up by 28%
- number of services have reduced by 15%

We see the devastating effect the greediness of council has on the local economy. A loss of 18,000 passengers a year, airfares that are punishing for the community and reduced frequencies are all the direct negative consequences of council's desire to generate an additional $200k a year in head tax revenue.

A typical regional airport head tax that is levied per arriving and departing passenger is approximately double the combined per passenger cost of the Federal Governments Carbon tax and removal of the en-route scheme that cost Rex some $5M per year. Rex welcomes Regional airports voicing their support in regards to the Federal Government's Carbon Tax and re-instatement of the en-route rebate scheme however councils and regional airports need to recognise impact of their own costs on regional airline viability.

3.2.1 Recommendations

- Broaden the scope of the Federal Government Direction pertaining to Sydney airport pricing to include regional airports.
- Appoint a third party ombudsman to adjudicate on regional airport negotiations with regional airlines

3.3 Security Screening

Increased security screening measures have added significant additional expense to the entire airline industry. In the case of regional services this can threaten the viability of thinner routes as airport passenger and baggage security screening costs are passed from airport operators (on behalf of the security contractors) back to regional airlines as an additional operating cost burden.

On 16 December 2009, the Australian Government released the National Aviation Policy White Paper, a single forward looking document providing regulatory and investment certainty for the aviation industry out to 2020 and beyond.

The White Paper (Chapter 8) announced regulatory changes to Australia's aviation's security regime and in making these changes, the Government communicated that it had weighed up the costs and benefits of security measures having regard to the nature and level of threats, and made clear its commitment to ensuring that Australia's security regime is "focused, proportional and sustainable". The Government informed the industry that it was conscious that security measures should not make air travel "unnecessarily less convenient or affordable".

The first security regime policy amendment, from 1 July 2010, required passenger and baggage screening for all aircraft greater than 30,000kg Maximum Take Off Weight (MTOW) operating regular public transport (RPT) services. Prior to this policy amendment passenger and baggage screening was required for jet services and not turbo-prop services.

Importantly, the second security regime policy amendment, required passenger and baggage screening for all aircraft greater than 20,000kg MTOW operating RPT services, was initially planned to come into effect on 1 July 2014 but was later brought forward to 1 July 2012.

Accordingly the current position is that the Federal Government has drawn a line in the sand for screening, effective from 1 July 2012, that has resulted in the larger aircraft being used by the two main domestic operators on regional routes (QantasLink 74 seat Q-400 and Virgin Australia 68 seat ATR operated by Skywest) being above the new MTOW threshold and the smaller (50 seat or less category) aircraft used by Rex being below the threshold.

For the regional airline sector, the revised security requirements present significant challenges, not the least of which is higher annual operating costs in the context of thin regional routes that don't have the economies of scale to support such high costs. The annual operating cost of security screening at a typical category 3 regional airport is in the order of $800,000 - $1,200,000 which far exceeds the profits made by the regional air operator on the route.

Despite Rex's aircraft not legally requiring screening, Rex has experienced situations whereby regional councils / airports have taken the matter upon themselves to become the security regulator in determining that Rex's aircraft should be screened due to other airlines operating aircraft to that airport that legally require screening.

In fact the Office of Transport Security (OTS) does permit regional airports to facilitate the segregation of screened and unscreened passengers via an approved Transport Security Program (TSP) and this is precisely what many airports practice, including Albury and Wagga Wagga airports (since July 2012) where Rex operates parallel services with QantasLink's 74 seat Q-400 aircraft that legally requires screening. As such, regional airports should follow the law as determined by the Federal Government's Office of Transport and Security (OTS).

A blatant case in point is the situation at Dubbo airport, where QantasLink operates a mix of 50 seat Q-300 aircraft and the 74 seat Q-400 aircraft (from March 2013), neither of which would have triggered the requirement for passenger and baggage screening under the previous security regime.

The 50 seat Q-300 MTOW is below the 20,000kg threshold so this aircraft still does not trigger the screening requirement post 1 July 2012. However the MTOW of the 74 seat Q-400 aircraft is above the 20,000kg threshold and therefore does trigger the screening requirement post 1 July 2012.

Dubbo council has arbitrarily and unfairly imposed the unnecessary screening arrangements on to all Rex services, which not only adds significant cost to Rex, but it is also defrays the security cost recovery away from the operator / aircraft that legally requires or triggers the costly security screening.

If a regional airport chooses to adopt something other than what the security regulators prescribe, then this is a prerogative for the airport, however the smaller regional operators should not be expected to pay for such a prerogative as it severely impacts the regional air service viability.

3.3.1 Recommendations

- Aviation security measures should be employed commensurate with the associated risk to each individual locality based on a realistic risk and threat assessment and as a result the security arrangements should not be applicable to turboprop aircraft unless the risk and threat assessment requires it.
- Regional airports should facilitate security screening in accordance with what the federal government regulators (OTS) prescribes.

3.4 NSW Regulated Routes Regime

In 2007 and 2013 Rex lodged submissions with Transport for NSW in regards to the NSW Regulated Regime. Both prior Rex submissions are attached as an appendix to this submission.

The current regulatory arrangements are applicable to regional NSW intrastate routes (linking Sydney) with less than 50,000 annual passengers.

The intent of the licensing was to ensure that smaller communities will be able to have an air service by providing a sheltered competitive environment and this is on the basis of routes with greater than 50,000 passengers being deemed as sufficient to support two or more competitive airlines.

Rex does not see any difference between regulated and deregulated routes in terms of the natural motivation that exists to develop routes which is mutually beneficial to both airlines and regional communities.

Rex believes that in the context of thin & marginal regional routes, it is more desirable to have a strong monopoly provider so that efficiencies of scale could be harnessed rather than having many marginal operators that are always close to the point of collapse.

When an airline collapses it can have a catastrophic impact as in most instances the routes previously operated by the collapsed operators will lose their air service forever, particularly when considering the NSW regional slot situation at Sydney airport.

Thin regional routes that lack economies of scale and necessary efficiencies will not be more sustainable due to the licensing of the route and this was evident with the collapse of Brindabella airlines in mid December 2013. In addition, the licensing produces market distortions and an inability for stakeholders to work closely together in the best interests of the longer term sustainability of the route.

Rex recognises the importance of having viable and effective regional air services and in many cases has entered into partnership agreements with local councils to co-invest in the service with a longer term approach. The licensing regime does not foster such an approach with most council's choosing not to consider such arrangements due to the closed and confidential nature of the license regime.

This was evident with the Moree to Sydney route following the collapse of Brindabella, when Rex felt that it could provide Moree with 3 return frequencies, peak time slots and some 60,000 annual seats. The council however chose to leave things entirely to the NSW route licensing process. It is not practical to have no collaboration between the regional airline and the regional council / community, in particular due to the licensing arrangements being applicable for a 5 year terms, which is an eternity in regional aviation.

This lack of ability to achieve 'meaningful' collaboration contributes to what was witnessed with the collapse of Brindabella airlines, which left many local councils throughout NSW with a significant debt associated with unpaid airport charges. The collapse of Brindabella also illustrates the lack of real protection that the NSW licensing regime delivers to regional communities.

Rex also questions the due diligence of the Transport for NSW route licensing process in that Brindabella airlines were awarded a number of NSW licensed routes within 12 months of their financial collapse. Due to the extent of monies owed ($37M) to creditors the financial warning signs should have been clearly visible.

Rex also has concerns with irregularities associated with the NSW route licensing process.

On 19 December 2013, following the grounding of Brindabella approximately one week prior, Transport for NSW revoked the Brindabella route licences. In response and also on 19 December 2013 Rex publicly announced its intention to apply for the Moree, Cobar and Mudgee to Sydney routes.

On 20 December 2013 Rex reiterated its public comments by stating that it would apply for the interim licences for Moree, Cobar and Mudgee and that Rex would be in a position to service Moree by 3 February 2014.

However also on 20 December 2013, Transport for NSW quickly awarded the non-exclusive interim licence for the Moree to Sydney route to QantasLink, which was only one day after the Moree licence had been revoked. Whilst the interim licences for the period until 22 March 2014 were non-exclusive, this effectively ruled out Rex as the passenger numbers were barely sufficient to support one carrier let alone two. It was also impossible to embark on such significant plans that required the allocation of significant resources and the securing of NSW regional slots at Sydney airport with no certainty of arrangements beyond the interim period.

On 20 January 2014, Rex called for its own 'expressions of interest', calling for regional cities within NSW with interest in having a Regular Public Transport (RPT) air service to/from Sydney. This also followed Rex's recruitment of around 10 ex Brindabella pilots. Rex fielded six submissions and subsequently chose to commence services between Armidale and Sydney (non-regulated) with effect from 28 March 2014.

In contrast to the very fast awarding of the interim Moree to Sydney route licence to QantasLink, Rex's wholly owned subsidiary Air Link submitted an application for an interim route licence to service the Cobar to Sydney and Mudgee to Sydney routes. This application was submitted by Air Link on 2 January 2014 and an approval was not received by Transport for NSW until 30 January 2014, almost one month after the Air Link application was lodged.

Both Cobar and Mudgee had been left without an RPT air services to Sydney when Brindabella was placed into receivership in mid December 2013 and the Rex Group questions the much delayed awarding of the interim licence by Transport for NSW. The Cobar and Mudgee communities had no air service, it was an interim and non-exclusive route licence and the Rex Group see's no good reason for the awarding of the interim licence taking almost one month.

Following the interim licence approval delay, the Rex Group was criticised by Transport for NSW for not proceeding with the interim licence, however it was no longer possible for Air Link to provide 'interim' services through until 22 March 2014 due to an insufficient sales window ahead of the planned commencement date of 24 February 2014. Air Link subsequently advised that it could not proceed with the interim licence arrangements for the Cobar and Mudgee routes and that it would continue discussions with both councils before deciding upon applying for the exclusive route licences beyond 22 March 2014.

The exclusive route licence submission deadline was 7 February 2014 and Air Link did not lodge an application ahead of that deadline due to negotiations on partnership agreements with the local councils not being formalised. As a result Air Link could not apply for the route licence and commit to a licence term of 4 years in the absence of air tight collaborative agreements with both councils.

Air Link subsequently considered the matter closed for the Cobar and Mudgee routes due to deadline being passed however on 21 February 2014 Transport for NSW advised that it had awarded QantasLink with the exclusive licence to operate the Moree to Sydney air service through until March 2018. Transport for NSW publicly advised that it was continuing to assess applications from operators to provide services connecting Sydney with Narrabri and Mudgee until March 2018. It was also confirmed that no applications had been received for the Cobar route and that "any interested airline is invited to apply".

As a result of this call, on 25 February 2014 Air Link submitted an application to service the Cobar and Mudgee routes with shared aircraft and crew resources however this was rejected by Transport for NSW on 11 March due to the application not being received prior to the earlier 7 February 2014 deadline.

Rex believes that the NSW regulatory regime is an obstacle for air operators working in partnership with the local councils and communities and the associated red tape is a disincentive for airlines particularly in the context of the license regime having no meaningful outcomes.

3.4.1 Recommendation

- The NSW Regulated Routes Regime should be abandoned.

3.5 Government Procurement of Regional Air Travel

The NSW Government should actively support the provision of NSW regional aviation through a considered approach to the procurement of regional air travel in NSW.

It is acknowledged that this is the role of government procurement however the broader interests of the State as a whole should be considered. What should also be considered by the NSW Government is the catastrophic significance of not having a sustainable regional air service. This not only relates to the cost of travel for NSW public servants, but also the broader socio-economic costs to the State of NSW. One only need to look at Queensland to understand the cost to the State government in having to subsidise many of the routes.

In Rex's experience the procurement of NSW Government related travel is particularly price aggressive, with a high focus on securing discounted rates of travel for NSW government travellers. This is despite the Travel Management Companies (TMC's) earning revenues applicable to transaction fees.

By way of example, Rex provides NSW Government travellers with a discounted fully flexible (full economy) fare, with last seat availability making this offering a 'maximum price to pay'. In addition Rex offers a range of standard published fares that are available for sale via the Global Distribution Systems (GDS) as used by Carlson Wagonlit Travel (CWT) who is the appointed NSW Government travel manager.

In addition, Rex also offers special internet based fares that can only be sold via the Rex website at www.rex.com.au and such fares are not made available via the GDS used by CWT due to the significantly higher distribution costs. The TMC can however connect their booking system to the Rex website in order to access the lower internet fares with the associated lower distribution cost and this system operated for many years with CWT in regards to the NSW Government related travel.

This was until Virgin Australia (VA) decided to move to the Sabre reservations system, which due to the high VA volumes sold by CWT triggered CWT to change its systems which no longer supported the direct connection with the Rex website and the discounted Rex internet fares. NSW procurement demanded that the Rex internet based fares be made available to CWT's higher cost distribution channels and that the imposition of a surcharge to recover the higher distribution cost would not be acceptable. After many months of negotiation the distribution cost surcharge of $7.00 applicable to the Rex internet fares was accepted. The lower priced internet based fares are designed to stimulate discretionary regional travel to the overall betterment of regional route performance, not to dilute the revenue associated with the NSW Government related travel.

Rex acknowledges that providing value to the NSW Government and its taxpayers is important, however this needs to be balanced with having a sustainable regional aviation industry that in return provides significant benefits to the State of NSW.

3.5.1 Recommendations

- The NSW Government should actively support the provision of NSW regional aviation through a considered approach to the procurement of regional air travel in NSW. This may include a travel policy that supports a higher usage of higher priced fully flexible fares.
- NSW Government procurement should provide transparent reporting on the higher volume competitive NSW regional routes that transparently details market shares (passenger share and revenue share) so that the 'best fare of the day' travel policy is strictly enforced. This is a true way of ensuring value for NSW taxpayers without forcing down prices on sole operator routes where passenger numbers are thin and the routes are marginal.