



INTRASTATE AIR SERVICES REVIEW

ISSUES PAPER

FOREWORD

The issues and points raised in this paper are a composite of stakeholders' views submitted to the Aviation Review and their presentation in the Issues Paper does not represent any form of agreement or endorsement by the State or by any other entity.

The review remains a work-in-progress and stakeholders are invited to provide further input at their convenience, but no later than 31 May 2008.

This issues paper has been prepared to inform the delegates to the Aviation Review to be held on 7 May 2008 and is made publicly available to provide information to all interested parties. The paper summarises the feedback received from submissions to the review. The detailed information provided in many of the submissions received has not been included in this paper, but will be fully considered during the analysis of all information received.

INTRASTATE AIR SERVICES REGIME OVERVIEW

The aviation industry is regulated at all three government levels:

1. At the Commonwealth level, aviation is regulated for standards of safety, security and order in the skies.
2. At the State level applicable to Western Australia, the *Transport Coordination Act 1966* and *Transport Coordination Regulations 1985*, and subsequent amendments, primarily but not exclusively, regulate availability and accessibility to air services within the State.
3. At the Local Government level, general revenue and various airport use fees support airport operating and infrastructure costs. The State also makes grants to local government for airport improvement through the Regional Airports Development Scheme (RADS).

The State requires all aircraft operating intrastate air services to be licensed with State authorities and is able to impose a range of conditions on each licence.



CURRENT LICENSING REGIME

The current regulatory regime was a direct result of the review recommendations provided in 2004. The principal focus of the recommendations was for Western Australia to establish a regulatory model for intrastate aviation with a view to facilitating the development of sustainable air service routes. However, the unprecedented demand largely created by the resource boom has meant that Government now needs to review and perhaps revise the regulatory framework to cater to an air services environment where the demand has grown on nearly all routes in WA.

The airline performance on the current Coastal and Northern Goldfields Networks has been strictly monitored by Government and the following key points were identified:

1. The cross-subsidisation model of grouping profitable routes with non-profitable routes has been successful to the extent that the route networks, including otherwise unsustainable routes, have been maintained through the period of the licenses.
2. Scheduled services have increased on nearly all routes.
3. Airlines' fleet capacity and skilled staff shortages (pilots and engineers) have contributed to the airlines not meeting performance standards against their Licence Conditions at times, in particular, on time performance.
4. Growth in the RPT sector has been driven by growth in resource/commercial passenger volumes and not necessarily by marketing strategy or innovation in the RPT sector.

COLLATION OF ISSUES SUBMITTED TO THE REVIEW

A challenging economic configuration

Uncertainties of the market

According to information sourced from the submissions received, the airline industry faces an ongoing contradiction in needing to acquire and maintain expensive capital assets (aircraft) in the face of **dynamic and short-term market pressures**. Indeed, the market in which airlines evolve is not a highly profitable one and is also subject to cycles. It appears from the submissions that have been presented to the Department that the cost of operating Regional Services within WA is significantly higher than operating mainland domestic flights.



Airlines are also subject to **high volatile input** costs such as fuel which has trebled in the past four years. They have very little control over fuel costs. Responsive mechanisms that can account for the increases and decreases are needed to address the air service operators' input cost changes on routes where fares are regulated by the State. This situation exemplifies the fact that even though airlines are regulated by the WA government, the market forces apply pressure on the government's policy parameters.

On top of these uncertainties, Western Australia suffers a **shortage of skilled staff** which emphasises the pressure on airlines, especially in the regions. This is a current reality and there is some indication that the situation may worsen in the short term.

Addressing Competition

This uncertain economic environment leads airlines to develop competition strategies which may not necessarily take into account the need to provide sustainable services within WA. According to comments received from submissions, airlines often play a strategic game that may lead to the failure or withdrawal of the other service when two are competing on one route, as their main objective is not to provide two sustainable services on one route. Rather, they may compete for one port in order to protect more lucrative passenger traffic on another.

Charter services seem to provide advantage to the air services operator through certainty of load and revenue, as well as lower administrative overheads through dealing with one customer. Regional Passenger Transport (RPT) are more costly to operate due to the mandated conditions required at Federal level and the overheads associated with providing a service to the public. Significantly, RPT operators have no control over load factors and must provide the service at the scheduled time regardless of the number of passengers on board. RPT services are inherently less flexible than charter services as changes to schedule to regulated ports require State approval. Charter services and RPT services are designed to fulfil the expectations of two very different types of demands: commercial travellers (FIFO/business), and tourists/VFR (visiting friends and relatives). A solution could be envisaged in changing this point of view. Charters and RPT do not necessarily have to be conflicting opposites and can coexist. The differing nature of the various passenger market segments need to be better appreciated whenever airports (or routes) are considered for regulation.

RPT operators are more active in working with the destination to increase in-bound passengers, particularly through the development and promotion of tourism. The availability of a scheduled service is also important for the quality of life in local communities, by providing air transport for education, medical and general social purposes.



Limits to the current regulated environment

Route configurations are dynamic and need to change according to the demand. By example, through the submissions it has been highlighted that there is no air link between the Kimberley and the Pilbara regions. This poor flexibility of routes creates significant deficiencies for business as well as creating restrictions in accessibility to tourist centres and adding excessive cost and time to travellers.

This point is one of the many which can be open to discussion. Following is a list of issues submitted to the Department regarding the current regulated environment. This list can provide a **guideline for discussion** for the way forward.

Regulated RPT Routes/Cross Subsidisation

- The current system of networks for the regulated ports was supported by some airlines, and there was argument that change from the current network licensing could result in one dominant carrier in the entire State. It was suggested that the current network sufficiency model has enabled RPT services to be provided to a number of communities that, without another form of market intervention, could not sustain air services.
- The current mix of regulated and unregulated airports and RPT and charter air services has not enhanced the provision of regional inter-town services. A case to reintroduce "milk run" services, by subsidy or otherwise, to connect north west towns may be examined.
- Towns with small populations have little local opportunity or capability to grow their markets to support the aviation industry that provides the services to them.
- Government, together with industry, to acknowledge the need to seek support from major regular users in underwriting services to marginal routes to ensure viability of RPT services. Such routes to be provided with protection from competition.
- While providing access to all, Regular Passenger Transport (RPT) services are more costly to operate due to the mandated conditions required and the overheads associated with providing service to the public.
- Airlines have little control over increased overhead costs and are not able to adjust pricing to match cost in a timely manner due to current administrative protocols and processes.
- Response time for Licence approvals needs to improve.
- The differing nature of the various passenger transport market segments needs to be considered whenever airports (or routes) are considered for regulation and vice-versa.

Charter services

- Charter fills a specific market requirement that is difficult to achieve with RPT.



- Charter operator should be allowed to increase seat capacity if it can be proven that the RPT operator's profitability will not be affected as the increased capacity will be new business.
- Retention of current policy allowing one charter per week per client to operate into any RPT port. However, there was general support for tighter monitoring and compliance measures used for such charters.
- *"Government should recognise commercial drivers, including a fundamental need for a steady flow of passenger traffic and wider network considerations and risks to scheduled operators such as seasonal and directional fluctuations of passenger numbers, versus the opportunistic approach of charter operators"*. This view was supported in other submissions.
- RPT route development largely depends on the incumbent RPT operator to access to all sources of traffic on the route. Therefore, allowing charter operations (other than those operating one charter per week), would reduce the airline's capacity to grow the route by offering increased capacity (larger aircraft) and more frequency.
- Charter services provide advantages to the air services operator through certainty of load and revenue and the lower administrative overheads through dealing with one customer, as such giving them a competitive edge against the RPT provider and providing lower cost for customers.

Licensing

- Remove licensing requirement for scheduled air services on open (deregulated) routes;
- Retain licensing of charter services into regulated ports, where more than one service per week, per client is undertaken.
- Licensing of routes to be over a five year term, allowing better planning options and commercial certainty for operators.

Competition

- While there was support for competition to be introduced when passenger numbers reached 50,000 per annum, there was equal support for a single airline policy to continue on turbo prop routes until the passenger volumes exceeded 60,000.
- New resource projects have the potential to increase passenger volumes significantly with relatively short notice.
- In one submission a direct quote from Canadian system review/report stated: *"the current priority for the future of small market air access should be to find individual operation environments that can support sustained and viable service, rather than pursuing the concept of increased competition where it cannot survive"*.



- While competition may be possible on most major jet routes, it may not be successful where there may be one or two major users, generally resource orientated, which may limit the potential of a new entrant to a small percentage of the market.
- It is important to consider the right mix of competition (airlines and their market edge in terms of aircraft type, aircraft fleet etc), when considering the introduction of competition. The current culture of airlines does not allow for competition in a environment of coexistence, but that may be more inclined to be adversarial.
- The Albany route should be opened to competition as soon as it can support more than one airline. In the interim the route should be regulated but put out to tender.

Airline Operations

- Airlines need to be cognisant of the importance of co-ordinated international marketing in development of tourist ports.
- Airlines' business process efficiencies could be improved in terms of booking systems, communication with passengers, baggage handling, check-in systems, boarding etc.
- Significant cost implications for airlines with increases in commodity prices, salaries for skilled staff, fleet management and maintenance.
- There is a need to find a source of skilled staff for airlines to meet demand.
- Route configuration needs to meet market demand.
- The airline industry faces an ongoing contradiction in needing to acquire and maintain expensive long-lived capital assets (aircraft) in the face of dynamic and short-term market pressures.
- There is the need to match or balance the capability of the industry with the expectations of the travelling public.
- While providing access to all, Regular Passenger Transport (RPT) services are more costly to operate due to the mandated conditions required and the overheads associated with providing service to the public.

Airport Infrastructure

- Parallel schedules on routes where competition is allowed places added burden on already inadequate infrastructure, particularly at Perth Airport.
- Security requirements are likely to increase to include smaller operators and smaller regional airports.
- Airline facilities are barely adequate to cover today's needs and need to be consolidated into one facility at Perth to cater for planned growth.
- Perth Airport does not encourage investment in facilities due to short lease terms and a non aviation view point of the requirements.



- Facilities at Perth Airport have not kept up with unprecedented growth as well as some of the other capital airports.
- Perth airport planning does not seem to focus on the holistic requirements of airline travel i.e. plane movements, passenger access, parking, taxis and traffic flows.
- Perth airport attempts at fixing parking problems have created other unaddressed issues with often long walks required along poorly defined or non-existent paths.
- Runway lengths at some regional airports are not suitable for the aircraft that passenger traffic would dictate.
- The Perth Airport proposal to develop a Regional Terminal has not fully considered the access requirements to other areas such as Perth city, suburbs or the international terminal.
- Western Australia has some of the most expensive airport charges in Australia.
- Perth Airport's focus and order of priority is towards larger aircraft. This will have a substantial effect on ports that require smaller aircraft to be sustainable.
- Airport infrastructure upgrades and capability improvements are beyond the financial capacity of local government. This includes consideration of security-related costs.
- Mechanisms to alleviate the congestion caused by the hub of most air services networks being centred at Perth Airport need to be addressed.

Government Considerations

- Should have a responsibility to ensure communities are provided with a level of access to air transport services.
- Policy should encourage decentralisation & subsidise more intrastate routes, thus removing the reliance on Perth as the hub, using a cost recovery model. This could be funded by passenger levy across all forms of air transport.
- Competition policies should ensure that an equal playing field is created in terms of frequency, access and capacity.
- It needs to be considered that regulation on intrastate routes may have a flow-on effect to interstate routes.
- Route protection is vital on some routes to ensure sustainability and viability.
- One-size route protection does not work. It needs to consider how the service is put together, i.e. passenger numbers are not a reliable indicator as they do not consider the size and frequency of the aircraft required to generate them.
- State planning guidelines for new projects are often restrictive and protracted, placing added burden on already inadequate regional facilities.
- The application of the Transport Co-ordination Act (1966) has been inconsistent.
- Decisions in relation to the Transport Co-ordination Act are often very slow.



- The route groupings chosen have provided natural barriers to airlines participating in an open tender process. This has led to the outcomes being largely pre-determined.
- The cross-subsidisation model has led to underperforming routes being subsidised by performing routes which has resulted in overall fares being higher.
- Any changes to the current regulatory regime may introduce the possibility of:
 - Loss of service destinations
 - Loss of frequencies
 - Loss of remote access
 - Loss of jobs
 - Destabilisation
 - Reduction of airline investment
 - Shift from RPT to FIFO to ensure stability
- Contracts for charter services in existence and extending beyond 31 December 2008 will need to be considered during the determination of any future intrastate aviation arrangements.
- Currently, the air services environment is one of growing demand. Any future regulation must also include provision for any situation where demand may fall in a particular location or even more generally.
- Getting mining companies to work collaboratively with existing and planned regional airline services has proven difficult at the working level.
- Airlines must have a sensible pricing structure and work collaboratively with package holiday providers.
- Airlines marketing strategies must work collaboratively with the States and destinations marketing initiatives.
- The aviation and tourism industries must be part of the Global Distribution System in order to support all sectors of the travelling public to accepted international standards.

General Issues

- Government to consider aviation policy when negotiating State Agreements with resource companies.
- Some communities hold the view that competition on air services will lead to increased services and lower airfares.
- The major competition on the Perth - Geraldton and the Perth - Albany air routes, both of which are about 400 km in length, is the motor vehicle where the trade-off between journey time and fare cost can be marginal, particularly for group travellers without time critical schedules. High cost of air travel and other performance issues are resulting in potential air users using other transport modes.
- There is a lack of RPT between Broome and the Pilbara.
- There is a lack of competition between Kununurra and Perth.



- There is an opportunity and demand for connections between Geraldton and the Pilbara. Direct flights will increase the opportunity for fly-in fly-out from Geraldton.
- There is regional comment that discounts are not being offered on Albany fares.
- Scheduling and on time performance are an issue for Albany, with some local belief that charters take precedence.



THE WAY FORWARD

Vision

The development and enhancement of an aviation network that will support the economic and social development of Western Australia.

Guiding Principles / Actions

- Identifying and resolving impediments to achieving a world class intrastate aviation network.
- Developing and applying consistent government policy to support the vision. This could include regulation, where market failure or potential failure is identified.
- Developing a range of benchmarks to quantify minimum requirements for each route.
- Identifying appropriate route configurations with levels of redundancy where possible.
- Enhancing cooperation between all stakeholders to maximise opportunities on routes, networks or at airports.

Alternative Forms of Regulation

Understandably, some incumbent airlines have sought retention of the current network regulatory regime, while others seek access and the deregulation of higher volume routes such as Geraldton and Albany.

In considering alternative solutions, Government needs to find an appropriate balance, which provides acceptable services on otherwise unsustainable routes, while minimising the cost to the travelling public and the taxpayer.

While deregulation is supported from a competition policy perspective, it could require high taxpayer support in the form of direct subsidies for otherwise unsustainable routes, such as Monkey Mia and Kalbarri. The alternative formation of networks to cross subsidise unsustainable routes, with periodic competitive tendering, is considered suboptimal from a competition policy perspective, but reduces the cost to Government and the taxpayer.

Options for consideration include:

- Direct Government subsidy for route/network;
- Open competition;
- Serial competition by periodic tender for:
 - Single route/Network(s);
 - Exclusive contract or dual contracts; or
- Any mix of the above.



Questions for discussion at the Seminar on 7 May 2008

1. What are the trade and competition considerations of an RPT route?
2. At what level or in what circumstances should competition be introduced at a port?
3. What criteria should define an RPT port?
4. What should be the route configurations? (City pairs, triangulations and networks, including or excluding Perth)
5. How do we ensure charter clients get choice of operator and should that determination be controlled? Should charter volumes be allowed to exceed RPT volumes and, if so, why and under what circumstances?
6. What criteria should be used for charter licence approvals?
7. How do we make intra-town services more viable?
8. What can we do to work more effectively around the current problems at Perth Airport to deliver services to the regions to expected standards?
9. What are the current transport infrastructure and security impediments to air service development to/from intrastate ports?
10. Should charters be regulated and, if so, what reporting and regulatory/penalty regime is appropriate?

Note: for the responses and input to the above questions please see document "Responses and Input from the Seminar Discussion Groups - 7 May 2008"