



## Regional Express Group

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# Response to Airservices Pricing Proposal 2016-2021

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## INTRODUCTION

The Rex Group welcomes the opportunity to provide a response to Airservices Draft Pricing Proposal 2016-2021.

The Rex Group comprises **Regional Express**, air freight and charter operator **Pel-Air Aviation** and Dubbo-based regional airline **Air Link**, as well as the pilot academy **Australian Airline Pilot Academy**.

Regional Express (Rex) is **Australia's largest independent regional airline** operating a fleet of more than 40 Saab 340 aircraft on some 1,400 weekly flights to 54 destinations throughout New South Wales, Victoria, Tasmania, South Australia and Queensland.

Rex was formed in 2002 out of the collapse of the Ansett group, which included the regional operators Hazelton and Kendell Airlines, in response to concerns about the economic impact on regional communities dependent on regular public transport air services previously provided by Hazelton and Kendell.

Rex operates a typical regional hub and spoke model with extensive services from Sydney, Melbourne and Adelaide airports and more recently a large network in Queensland where Rex operates a mix of regulated and non-regulated RPT services.

The provision of regional air services is not only critical to regional Australia, but it is also critical to Australia's national interest. Since Rex was formed in 2002, we have witnessed the demise of at least 10 regional airlines which illustrates the fragile nature of this industry. Rex has survived due to its intense focus on efficiency that has driven significant activity level increases over the past 13 years.

Importantly, these activity level increases have directly benefited regional communities through affordable fare pricing and increased flight frequency. Rex's philosophy towards regional air services is summarised in the following public statement on its website:

*"Rex has its roots firmly in the bush and in country Australia. Its tagline boldly affirms that 'Our Heart is in the Country'. Rex believes that the bush needs and deserves an air service of quality that provides good connectivity with capital cities at affordable prices. Rex seeks to fulfil these expectations. Since its formation, Rex has steered a course balancing the needs of regional communities for extensive and affordable air services and to be economically viable and sustainable."*

Rex is an efficient competitor in regional aviation. The average Rex ticket price paid by its passengers has only increased by approximately 1% annually since Rex first commenced operations in 2002, which is significantly less than CPI.



As a result of Rex's unique approach, when comparing back to FY03 (Rex's first full financial year) we have seen passenger numbers increase by approximately 70% and Available Seat Kilometres (Capacity) increase by approximately 35%. This has directly translated into significant increases in both Airport and Airservices revenue due to these activity levels underpinning the recovery of service costs.

*Airservices* plays a vital role in ensuring that Regional airlines can continue to operate and provide crucial air services to regional centres. This role includes assisting, through efficient service provision, airlines and air operators to themselves remain as efficient as possible and hence better ensure their viability.

### FLIGHT ACTIVITY VOLUME FORECASTS

It is disappointing to us that Regional Express (Australia's largest independent regional airline) is not referred to at all anywhere in IATA's *Activity Forecasts for the Period 2014-2015 to 2020-2021* Draft Final Report of 25 February 201. Qantas Link and Virgin Australia Regional Airlines are considered in detail however.

We also question some of the Regional Load Factor forecasts and predictions contained within the report.

It is also of note that Airservices' own Draft Traffic Forecast predicts little to no growth in *tonnes landed* at several Rex regional ports. As an example, the Draft Traffic Forecast indicates no tonnes landed growth at Albury over the term of the Pricing Proposal whilst we will experience a 23.7% increase in Terminal Navigation charges over the same period.

### PRICE INCREASES

Page 7 of the Pricing Proposal (Table 1) displays the *weighted average price increases by service line*. Whilst the explanatory text above the table on page 7 advises that the price growth is an average nominal rate of 3.3% per annum, it is not an accurate reflection of the impact to us and additionally the increases particularly in the first years are well in excess of current or predicted CPI.

The first year (16-17) increase in En route charges for Rex is proposed to be 4.4% (aircraft up to 20 tonnes).

Terminal Navigation charges at our two largest hubs of Sydney and Adelaide will both be subject to price increases in the first year of the proposal of 5% with a 23.7% increase over the 5 years.

ARFF charges are proposed to increase by 8.6% (Category 6 aircraft and below) in the first year and 35% over the 5 year proposal. It should be additionally noted that these are the price increases at the applicable airports and does not include cost increases to us as a result of required new services at a particular port.



## ARFF CHARGES

Rex does not support the proposed general increases in ARFF charges. A price increase of 8.6% in the first year and 35% over the period of the Proposal is excessive.

The Saab 340 operated by Rex is a category 4 aircraft. We feel that we should not be subject to ARFF charges however if charges must be levied on us then there should be a “below category 6” (not cat 6 and below) charge to cater for such aircraft.

Additionally and as Rex has argued for some time, we feel that the hard trigger for the introduction of an ARFF service should be reviewed. Any passenger number threshold should initially trigger a full review and risk assessment and not the automatic introduction on an ARFF service. We accept that this a Civil Aviation Safety Authority regulatory requirement.

## RETURN ON CAPITAL

It is noted that the *Nominal Vanilla Weighted Average Cost of Capital (WACC)* estimated and used in the proposed Pricing Proposal is lower than that used in the development of the previous Pricing Proposal however this is to be expected, if nothing else, due to the reduction in market interest rates since then.

The Rex Group questions the general principle and expectation that Airservices should calculate its costs, and therefore its maximum allowable revenue, using the formula outlined on page 16 of the Pricing Proposal. Namely that it should provide a commercial rate of return.

The Pricing Proposal notes that the ACCC will assess Airservices’ price notifications against the “Building Block” approach which includes Return on Capital. The Pricing Proposal then points out that this methodology is used by the ACCC as part of its regulatory decision making across a number of industries including pricing for airports, postal services and energy utilities.

This is an appropriate method to apply in assessing if a commercial entity (such as many of the above examples) is charging reasonably but it does not necessarily consider the principle question of whether a Government owned Corporation, providing a service such as that of Airservices, should be charging to achieve the same commercial rate of return.

Rex believes that a WACC of 7.8% is too high.

## NETWORK vs LOCATION SPECIFIC PRICING

As Rex has maintained over several submissions, we continue to stress how critical it is that Airservices accept and maintain the concept of network pricing. If a movement towards full, or even increased, location specific cost recovery is taken then the viability of vital air services to many regional communities will be seriously jeopardised.

We strongly oppose and warn against any move towards location specific full cost recovery and charging.



To use ARFF as one example, if the full costs associated with the establishment and ongoing provision of the service at a location were to be recovered from operators using that location then it would almost certainly have a significant negative impact on demand and could in fact lead to a reduction in passengers below the initial trigger level for the service. Apart from the impact on passengers and the community, this would, in this case, also potentially leave Airservices with a stranded asset.

## IMPACT OF PRICES

Table 3 on page 10 of the *Pricing Proposal 2016-2021* claims to provide “a comparison of current services charges to those proposed for selected aircraft operations and routes”.

Included in the table are 4 routes for the SAAB 340 (the Regional Express airline fleet) with two of those being routes operated by Regional Express, namely Wagga-Sydney and Melbourne-Albury.

The right of the table suggests, for the Wagga-Sydney route, a per pax impact from change in total charge of \$0.35, an Average pax fare (return) of \$699 and a percentage impact on ticket price of 0.1%. The same resultant percentage increase on ticket price is suggested for the Melbourne-Albury route.

The data used for this impact table is not a correct reflection of the economic reality and therefore does not arrive at the correct percentage impact on ticket prices.

Firstly the table appears to assume an average Load Factor of between 75% and 85% on the selected example routes and spreads the cost increase over that amount of passengers. An average load factor of between 75-85% is completely unrealistic. An average load factor of between 50-60% is more realistic. Rex’s RPT network average Load Factor as reported to the market most recently on 28 August 2015 was 54.7%

Secondly the “Ave PAX fare” in the table utilises “flexible fares” (as indicated in the \*Notes). This again is in no way reflective of an actual “average fare” and a fare in the vicinity of half that is more realistic. Rex’s RPT network average one way fare, as reported to the market most recently on 28 August 2015, was \$195.40.

With these metrics correctly considered, (for both selected Rex routes) the percentage impact on ticket price is around 3 times that claimed in table 3 of the Pricing Proposal 2016-2021.

Furthermore it is of limited value to single out one specific aspect (the increase within the cost) of an airline’s costs and then calculate and describe it as a percentage of the individual passenger ticket price.



## ALTERNATIVE PRICING ARRANGEMENTS

The Rex Group does not support the Alternative Pricing Arrangements outlined on page 9 of the Pricing Proposal.

The detail provided indicates that the Indian Ocean charge proposed by Emirates Airlines, if implemented, would see the existing en route charges to us increase even further than they are proposed.

Rex can also not accept a proposal that would see Melbourne Airport Terminal Navigation charges increase by a further 8% over and above the increases already proposed and as such does not support the hybrid price proposal for Avalon and Melbourne airports.

