

Consultation Paper 3.2

Principles of a System of Route Licensing for Aviation Traffic

Executive Summary

A licensing system is necessary to:

- Assess on which international routes it is possible to envisage competition to Ariana without undermining the overall policy of building up Ariana.
- Assess which domestic routes are likely to be commercially viable and which will require subsidy.
- Decide on applicants for commercial routes and to invite tenders and decide which to accept for routes considered necessary but not commercial.

The principles of the licensing system should be written into legislation. The government should have the power to determine from time to time the weight to be given to each objective.

Operators selected should satisfy financial and safety criteria. They should be established in Afghanistan but, following the terms of the National and Foreign Investment Law, those selected for domestic routes need not be owned or controlled by Afghan nationals.

On commercially viable domestic routes, operators selected should be given a licence for, say, five years and a period of, say, three years to develop their product before competing applicants are considered.

The selection of domestic routes considered necessary for social or wider economic reasons should be made in consultation between central and provincial government; and should conform with criteria setting out the social considerations to be met.

In seeking tenders, the licensing authority should specify the service to be provided, and invite operators to submit proposals indicating how much they would charge to provide such a service. The licensing authority should invite the tenderer to specify what fares he would charge and take a judgment on the totality of factors (quality of service, fares or charges for freight, the amount of subsidy required).

The system should be built up in house before being transferred to an independent agency. For this purpose MCAT should set up a Project Management Unit in the Reform and Restructuring Office (see Consultation Paper 3.7) to develop the system in the light of the geographical circumstances of Afghanistan and to discuss with provincial councils how best to start the process for the selection of non-commercial routes to be subsidised and to work out procedures suitable to the Afghan system for the receipt and handling of applications. This work should be done by Afghans or by people with a detailed knowledge of Afghanistan.

Recommendations:

MCAT should continue to prepare a system for route licensing of air traffic.

Actions:

The next step is for MCAT to set up a Project Management Unit in the Reform and Restructuring Office (RRO) (see further Consultation Paper 3.7) to develop further the above principles, and to work out procedures suitable to Afghanistan. TSR suggests that although much of this work will have to be done by Afghans (or by people with a detailed knowledge of Afghanistan), it would be an advantage to seek outside assistance from a country with experience of dealing with the provision of subsidised services to remote areas. TSR therefore suggests the recruitment of one specialist for one year, at an estimated cost of USD 250,000.

Introduction

The TSR Phase 1 report proposed differential regulatory regimes for international and domestic aviation traffic. Both - but in particular the domestic aviation regime - envisage that some sort of route licensing system will be necessary. The issue is in essence to find a licensing system for Afghanistan which allows Ariana on international routes to develop an appropriate network of services and to help create a domestic airline system which can compensate for the lack of road infrastructure and develop a network of services which allows the country's economy to develop and sufficient mobility to be provided for its citizens.

The Rationale behind the Licensing System

This paper deals with the principles of aviation route licensing and how the system would work including the selection of routes and the rules for tendering and choice of carriers. However it deliberately does not deal in any way with the issue of where the licensing authority should be situated. It is argued elsewhere in these papers that the best way of organising the licensing process would be to have it administered by an agency outside central government but responsible to it. However the system should be built up within government and subsequently transferred as a working operation to a separate agency. The basic reasons for this are the urgency of getting the system working; and the administrative difficulty of doing it at the same time as creating a new organisation.

The TSR Phase 1 paper suggests the factors which the Government of Afghanistan should take into account in establishing a route licensing system as follows:

- Developing a healthy / profitable / competitive aviation industry.
- Meeting the needs of the consumer.
- Increasing the maximum feasible degree of competition.
- Meeting the need of the economy as a whole.
- Increasing employment or improving the conditions of employment in the industry.
- Meeting the needs of the regions.
- Meeting the government's environmental objectives.

In the present circumstances of Afghanistan, two extra principles might be added:

- The revenue which the Afghan government might derive from the service.
- Meeting the objectives of the government's gender policy.

These principles should be set out in legislation, with a provision which allows the government to decide the priority, or weight, which the licensing system should accord to each of them. These weights might vary depending on the types of operation to which they are applied. Below is set out more detailed policy directions and the legislation should give effect to these as appropriate.

In Phase 1 of the TSR an in depth analysis was made as to what aviation policy would on balance be of the greatest benefit to Afghanistan and its people. These policy directions make a clear distinction between domestic and international aviation services. With respect to international services TSR recommends that the government should provide protection and

support for Ariana until it is firmly re-established. This will involve licensing competing Afghan airlines only on routes where competition from a second Afghan airline will not damage the viability of Ariana on that route.

TSR therefore expects that at least initially the possibilities for a competing Afghan airline to operate will be mainly, if not entirely, limited to the routes to the neighbouring countries. The policy will also involve negotiating bilaterals with other states which encourage cooperation rather than competition. Such policy is necessary in order to:

- Give Ariana a reasonable opportunity to rebuild its network and facilitate any arrangements with third countries' airlines which are thought necessary to help in its reorganisation and re-establishment.
- Give the government a genuine option in due course of whether, and to what extent, to privatise Ariana.

With respect to domestic routes the equation is somewhat different. The TSR Phase 1 paper suggests a much more pro competitive approach. It seemed to TSR that the overriding principle should be to meet the needs of the Afghanistan economy as a whole and that anyone, even non Afghan companies, should be able to bid to provide services on domestic routes. However TSR recognises that the needs of the regions and in particular isolated and rural communities would not be met by total reliance on commercial services. Therefore the liberal regulatory aviation policy on domestic routes must be coupled with a robust essential air services programme to ensure that regions and peripheral communities are served. This issue is dealt with more fully later in this paper.

Basic Requirements for Operating Licences

There are a number of requirements which should be applicable to all operators wishing to get a route licence. These should include the following:

- The operator should be established in Afghanistan. This need not mean that the operator should be owned or controlled by Afghan nationals if the civil aviation law currently in draft form reflects the terms of the National and Foreign Investment Law (808 of 2002). But it does mean that the management of the services, which it proposes to run, should be based in Afghanistan.
- The operator is sufficiently well organised and dependable. This means (and the rule is common in the aviation world) that it must meet the following criteria:
 - It can meet at any time its actual and potential obligations for 24 months from the start of operations.
 - It can meet its fixed and operational costs incurred from its operations (including proposed operations) for a period of three months from the start of its operations without taking into account any income from its operations.
 - It should have a business plan covering the first two years of its operations in Afghanistan; it should detail all financial links under any other commercial activities in which the applicant is engaged either directly or through related partnerships.
 - Proof or equivalent that those in charge of the management of operations are of good repute, that they have not been declared bankrupt and that they have not committed serious acts of professional misconduct or a criminal offence.

- It has adequate insurance to cover liability in case of accidents in particular in respect of passengers, luggage, cargo, mail and third parties.
- Insolvency or similar proceedings against an air carrier would immediately result the loss of the licence.
- The operator should also be required - as again is normal elsewhere in the world - to provide information on its financial soundness. At Annex 1 is a list of the sort of things that the licensing system might require, based on the Swedish system. In the case of Afghanistan it might be sensible, at least initially, for the legislation (or government policy) to allow the licensing authority to waive the need for the operator to supply the information which it considers too onerous, or unnecessary, in the circumstances.

Ariana for example, should be assumed to satisfy the requirements on the basis of its contract with the government (proposed in other papers). Gradually, by this means, the licensing authority would build up knowledge of the economics of air operations in Afghanistan which would be useful both in assessing whether fares were reasonable and, perhaps more important, assessing what would be a reasonable level of subsidy for a non-commercial service.

- The operator possesses the appropriate safety certification. Since under this proposal operators have to be established in Afghanistan this means satisfying Afghan safety rules.

There should be a requirement that those in MCAT responsible for safety regulation coordinate closely with the officials in charge of the licensing system. There is always the risk that financial aspects might have a bearing on safety although nothing to do with technical safety aspects. The need for this coordination will exist whether the licensing system is carried out inside government or (in due course) in a separate agency.

Requirements for Commercial Services

There may well be some domestic routes which are already being operated commercially when the licensing system comes into operation. The operators of these routes should be given route licences automatically, and the licensing authority should have the power to waive as many of the basic requirements (except those on safety) as is thought reasonable.

Although at any particular time the aviation experts in the Afghan government will be able to make a good assessment of which routes might be expected to support (new) commercial services, the only way to check its assessment will be to invite potential operators to apply. This invitation should include Ariana, Afghan private sector operators and non-Afghan owned operators established in Afghanistan.

There are two possible approaches to the handling of application:

- The first is that to ensure stability the licensing authority should decide what level of service a route can support and license a single carrier to provide it. The licence should be for a reasonable period - say five years - and the operator should have a reasonable period - say three years - to get himself established and develop his

product. A second operator would not be allowed on that route within those three years.

- The second is to allow any applicant to run the services he applies for (provided of course that he satisfies the basic requirements set out above). The disadvantage of such a system is that it may entail a risk that an applicant for a route already being served by an existing operator may be too optimistic in his assessment of the market potential and that as a result one or other of the services may be forced to close. The advantage is that it will increase the pressure on the operator, by way of competition or the threat of it and thus help to ensure that the services provided are run economically and efficiently. Nevertheless, in some cases choices may have to be made since some applicants may be willing to run services on routes where they are the only operator, or possibly one of two operators, but not willing to take the commercial risk as a third or fourth operator.

On the whole, TSR is inclined to recommend (i) above, on the grounds that the greater stability which it provides will be important in the present state of the re-development of the Afghan economy.

On international routes, however, the primary principle should be that new operators should be licensed only if the service was judged to be unlikely to undermine the viability of Ariana on that route. In making that judgement the licensing authority should take into account the provisions of the relevant bilateral and of the possibility that to license a second Afghan service on a route may also entail either a second operator or increased services by an existing operator from the other party to the bilateral.

Requirements for Non-commercial Services

This part of the licensing authority's work should be confined to domestic services. It is, in TSR's view, likely to constitute the greater part of its work, at least initially.

The methodology and criteria for the choice of routes

This involves two issues:

- The mechanism for selecting routes for the operation of which tenders are to be invited.
- The criteria which would have to be satisfied for a route to qualify.

In TSR's view provincial councils should in principle make recommendations to central government regarding which routes they considered qualified for subsidy in the light of criteria agreed between them. This process should in time produce a country-wide plan of essential services which should be regularly reviewed as the economy grows and the road network is re-established. It may well be, however, that initially the provincial councils might feel they lacked the administrative capacity to nominate routes and negotiate assessment criteria. TSR does not have the knowledge of provincial councils to assess whether this is in fact so. If it is, however, there might be an initial phase under which the licensing authority took the initiative. This might be as follows:

Step 1: The licensing authority undertakes the work on the routes to be established - probably under a TA of some kind. That would take about 6 to 12 months and it would be done and implemented province by province.

Step 2: The proposed routes are sent to the provinces for review and comments.

Step 3: The routes are then offered for service provision after the government has agreed to provide a level of subsidy.

The routes would be in place for three years and then the provincial Councils would be able to recommend the review, replacement or alteration of the routes.

The choice of routes to be subsidised should be made by central government after discussion with the provincial councils, and of course in the light of the money available. On the one side they must obviously be services that the workings of the market will not produce; on the other side it will be necessary to develop criteria which would limit the services to those areas which would draw most benefit from them. These might include the following:

- The community has an aerodrome that meets safety standards and the community is capable and committed to maintaining it.
- The permanent population of the catchment area likely to be served by the service must be of a certain minimum size. Proposals for these minimum numbers will be part of the process of negotiation between the government and the provincial councils.
- There must be a demonstrated need for at least a minimum level of air service (say weekly, though this too will require a political judgement by the Afghan authorities); and a minimum potential use (say 15 passengers per flight (75% of the capacity of a 20 seater aircraft)). This criterion might in due course be made more sophisticated and expressed as a minimum percentage of originations per capita per year.
- The community to be served should be sufficiently remote in terms of surface travel time to a population centre or neighbouring community which does have at least a weekly air service to a larger community. One possible rule of thumb might be to deny a subsidised air service to any destination that is within, say, half of day's surface journey to somewhere that does have at least a weekly air service.

Whilst some of the criteria are there to ensure guaranteed minimum air connections some should also be there to ensure that sufficient connections are there to link citizens in the provinces to Kabul and also that isolated provinces have access to developed hospital services, specialist schools and universities, and ensure the possibility of delivering equipment, mail and other necessities. Each such route should be considered vital for the economic development of the region in which the airport is located, to the extent necessary to ensure on the route the adequate provision of air services satisfying fixed standards of continuity, regularity, capacity and pricing which air carriers would not assume if they were solely considering their commercial interest.

These criteria will, of course, need further elaboration in the light of the density of the Afghan population, and the political need that they should be fair to all parts of the country. These other criteria would again be for the provincial councils to suggest in their submissions to the government on essential services.

The method for inviting and assessing tenders

There are two basic methods by which tenders can be invited. The first is to settle what the government is prepared to pay for a service between destinations A and B and to invite operators to say what services they would provide, what aircraft they would use, what fares they would charge and so on. Many of the details listed in Annex 1 would provide the basis for questions which the tenders should answer. The difficulty would be to assess what would be a reasonable sum to offer. It would, to be sensible, have to be related to the likely costs of, say, a weekly operation by a 20 seater aircraft between the two selected points. These figures might, at least initially, not be known to the licensing authority. This is also the danger that if the sum offered is calculated badly it might lead to unnecessarily extravagant services.

The second is to specify the service required (e.g. a weekly service with, say, a 20 seater aircraft or a service twice a week, or possibly a series of options) and invite operators to submit proposals indicating how much they would charge to provide such a service. The licensing authority could either specify the fares it was prepared to accept that the operator would charge; or alternatively, and probably better, to invite the tenderer to say what he would charge and then take a judgement on the totality of factors e.g. the quality of the service, the fares (or charges for cargo), and the amount of subsidy required.

TSR understands that Swedish experience in providing for services to remote areas indicates that the second method sketched out above has tended to produce the better offers. It is this which TSR recommends.

In the tender the following should be presented:

- Company presentation - A presentation of the company including ownership, organisation and the last annual report.
- Evidence of an Operator's License (OL) and an Air Operating Certificate (AOC).
- Experience - Provide information on experience of air service operations.
- Requested financial remuneration - Tenders shall be given in Afghan currency.
 - In the tender it shall be clear for each service how much money is requested for operating the service in question.
 - The remuneration rates that are presented shall be based on an estimation of the costs and the revenues of the company.
 - Remuneration should only be allowed for the flight traffic and for relevant costs incurred at airports directly used by the service.
- Financing plan for the service - A financing plan for the period from decision to first payment from the contracting authorities shall be declared separately.
- Pricing, types of tickets and ticket fares - In the tenders shall be indicated the planned ticket fares and the conditions for the various price categories. Potential changes of the structure of fares for the second and third year should be approved by the contracting authorities.
- Distribution of tickets and booking system - Describe what distribution channels will be used, where tickets are going to be available for purchase and in which printed publications the time schedule and ticket fares will be published.
- The calculated passenger volume and revenue (for a period of perhaps 3 years).
- Organisation of the traffic undertaking - The tenderer shall describe how the following points will be met: technical support, how the tickets will be made available to the public, arrangements for ground handling.

- Information about possible sub-suppliers or sub-contractors.
- Accessibility - Describe the accessibility for persons with functional disability.
- Quality - Describe how the company aims to control the quality of the service.

Following the submission of the applications the licensing authority should assess them having regard to:

- The amount of money demanded to provide the service.
- The air fares and conditions which can be quoted to users.
- The guaranteed quality.
- The organisation of the service.
- The promotion of facilities for the handicapped.
- Any arrangements made for women.

These various factors will then be graded according a scale which the licensing authority will determine.

Recommendations

Continue to prepare a system for route licensing of air traffic.

Actions

The next step is for MCAT to set up a Project Management Unit in the Reform and Restructuring Office (RRO) (see further Consultation Paper 3.7) with the following functions:

- To develop further the above principles in the light of the particular geographical circumstances of Afghanistan and in particular to discuss with the provincial councils how best to start the process for the selection of non-commercial routes to be subsidised.
- To work out procedures suitable to the Afghan system for the receipt and handling of applications.

TSR suggests that although much of this work will have to be done by Afghans (or by people with a detailed knowledge of Afghanistan), it would be an advantage to seek outside assistance from a country with experience of dealing with the provision of subsidised services to remote areas. TSR suggests that Sweden and Australia, both of which have well-worked out systems would be suitable sources of expertise.

TSR suggests the recruitment of one specialist for one year, at an estimated cost of USD 250,000.

ANNEX TO CONSULTATION PAPER 3.2

OPERATIVE LICENSE

Note: Throughout this annex, and throughout the paper, the figure of 20 seats has been used to distinguish between aircraft suitable for thin routes to parts of Afghanistan needing only a basic service and larger aircraft suitable for thicker routes and more sophisticated services. It should, of course, be reviewed from time to time in the light of the aircraft available and the dividing line should be used flexibly.

FIRST-TIME APPLICATION

The granting and validity at any time of an operating license shall be dependant upon possession of a valid Air Operator's certificate (AOC) specifying the activities covered by the operating license. To apply for an operative license the following information / documentation shall be sent to the aviation authorities :

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|----------------------------|---|
| GENERAL INFORMATION | <ul style="list-style-type: none"> - Name, address and tel / fax / telex - Organisation number - Organisation chart - Management - Ownership - Proof of good repute of persons managing the undertaking |
| ACTIVITY CONCERNED | <ul style="list-style-type: none"> - Number of airplanes - Type version and nationality of planes - Registry terms - Ownership and leasing conditions - Certificate of insurance conditions |

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|-------------------------------------|---|
| <p>FINANCIAL INFORMATION</p> | <ul style="list-style-type: none"> - Business plan for the two first years of activity ¹. - The most recent internal management accounts. - Audited accounts for previous financial year if available. - A projected balance sheet, including profit and loss account, for the following two years. - The basis for projected expenditure and income figures². - Traffic/revenue forecasts. - Details of start-up costs incurred in the period from submission of application to commencement of operations and an explanation of how to finance these costs. - Details of existing and projected sources of finance. - Details of shareholders, including nationality and type of shares to be held, and the Articles of Association. If part of a group of undertakings, information on the relationship between them. - Projected cash-flow statements and liquidity plans for the first two years of operation. - Demonstration the possibility to meet actual and potential obligations for a period of 24 months. - Demonstrate the possibility to meet fixed and operational costs incurred from operations according to its business plan and for a period of three months from the start of operations, without taking into account any income from its operations. - Details of the financing of aircraft purchase/leasing including, in the case of leasing, the terms and conditions of contract. - Registration certificate and a transcript of articles of association for joint-stock company.³ |
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¹ Applicable for undertakings aimed at running a service with airplanes of which the highest permissible starting weight is 10 tons or more and / or which has 20 seats or more. For smaller airplanes, with permissible starting weight less than 10 tons and / or less than 20 seats, accountant certificate showing a minimum net capital of xxx and business plan for first activity year is required. The actual sum should be assessed from time to time in the light of circumstances in Afghanistan.

² On items such as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, insurance, etc.

³ Other company than shareholding: an extract from the commercial registration office and a birth certificate / registration certificate for company holders is required.

UPDATING INFORMATION TO AVIATION AUTHORITY

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| EACH YEAR | - Revised accounts. ⁴ |
| UPON REQUEST | <ul style="list-style-type: none"> - Audited accounts not later than six months after the end of the relevant period and, if necessary, the most recent internal management balance sheet. - A projected balance sheet, including profit and loss account, for the forthcoming year. - Past and projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, insurance, etc. Traffic / revenue forecasts. - Cash-flow statements and liquidity plans for the following year. |

⁴ For undertakings that holds a valid licence for activity with airplanes of which the highest permissible starting weight is 10 tons or more and / or which have 20 seats or more.