

Welsh Government: Evidence Paper in advance of the Public Accounts Committee Scrutiny Session – 4.06.18

Cardiff-Anglesey Intra Wales Air Service Public Service Obligation (PSO)

SECTION 1: The salient findings of the RPS/Northpoint review and any action the Welsh Government has agreed to undertake from the findings.

SECTION 2: Clarification of the current contractual position.

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In early 2016, the Welsh Government commissioned a thorough review of the PSO Air Service, which was undertaken by external aviation specialists RPS and Northpoint Aviation. A Public Service Obligation (PSO) is a publically-funded service which would not otherwise operate commercially. The review considered a wide range of matters for the future of the service including broad context, marketing and market conditions, location options, airfields, airlines, regulation, ownership, security, scheduling, rotations, technical issues and a range of other matters. Below is a high level summary of the salient findings of the review.

Findings

- The review strongly recommended the continuation of an Intra Wales Air PSO between Cardiff and Anglesey.
- The route had previously suffered from failure primarily due to the selection of small, susceptible operators.
- Passengers had been put off by smaller aircraft, inconsistent schedules and safety issues associated with small operators and their aircraft.
- Despite the previous failures, there is a real opportunity to consolidate and grow the service going forward.
- A larger, more substantial airline with bigger aircraft would improve customer perception and confidence, thereby increasing demand.
- The subsidy cost of a larger operator is likely to be greater; however the increase in cost is likely to generate an increase in Gross Value Added (GVA).
- At the time of the review, the GVA generated by the PSO was approximately equivalent to the subsidy cost being paid to the operator at that time.
- There are opportunities to improve Anglesey Airport which would in turn enhance the success of the PSO, and increase the economic benefits to North West Wales.

Actions and Timescales

- **November 2014:** Links Air began operating 4 year contract after it won a full and competitive tender (2 bidders – Links Air and Van Air).
- **October 2015:** Links Air's Air Operating Certificate was suspended by the UK aviation regulator, the Civil Aviation Authority (CAA) on grounds of safety.
- **January 2016:** Links Air ceased operating the service with no notice (Friday afternoon).
- **January 2016:** City Wing & North Flying stepped in to operate a joint 3 week contract ensuring continuous service provision, while competitive procurement was undertaken. Services began on the Monday morning.
- **February 2016:** Van Air won 7 month emergency contract (3 bidders – Van Air, Eastern Airways and North Flying).
- **Spring 2016:** The Cabinet Secretary for Economy & infrastructure ordered a full review of the PSO air service, which was undertaken by external specialists RPS and Northpoint Aviation.
- **September 2016:** Van Air's contract was extended to May 2017 while the review of the service was completed.
- **March 2017:** the CAA withdrew Van Air's Foreign Carrier Permit (enabling it to fly in UK airspace) on the grounds of safety. As a direct result, Van Air's partner organisation Citywing subsequently went into liquidation shortly afterwards, resulting in Van Air no longer being able to successfully deliver the contract).
- **March 2017:** Eastern Airways was appointed via a 1 month rolling emergency contract ensuring continuous service provision. Services began on the Monday morning.
- **July 2017:** The First Minister announced the Cardiff-Anglesey PSO would continue to be supported by the Welsh Government for the long term.
- **December 2017:** Eastern Airways contract was extended to March 2018.
- **January 2018:** The final report was published by the Welsh Government.
- **March 2018:** Eastern Airways contract was extended to September 2018.

The review of the service was initiated in a time of considerable uncertainty for the PSO, as a result of the political and economic changes that Wales and the UK was faced with. The EU referendum result was taken into consideration alongside a change of aviation regulations for using smaller aircraft on scheduled services across the UK and a second operator-failure in around 15 months.

The initial scope of the review was significantly increased in line with the above changes, resulting in wide ranging results and complex findings from a number of different studies which were undertaken over a 12 month period. These then needed to be brought together to provide a single overarching picture which would enable the consultants to make sound and clear recommendations for Ministers on the future of the PSO.

A number of draft technical reports were received by officials during 2016 and early 2017 which were then subject to significant challenge. We wanted to ensure the evidence presented was robust and clear, and we worked with the consultants to simplify as much of the technical information as possible.

Whilst the overall findings of the report and the recommendations to retain and grow the service had been made clear by July, the above mentioned simplification and refinement of the

published report was undertaken in the latter half of 2017, enabling the final report to be published in January 2018.

Continuing to provide intra-Wales air connectivity via the Cardiff-Anglesey PSO is a clear, ongoing Ministerial priority. This includes ambitions to grow the route significantly over the next contract term, aiming to increase patronage on the route sufficiently to enable the increase in size of aircraft used to a circa 30 seat operation. This will in turn present opportunities to do more with the aircraft during 'PSO downtime' – for example, during the middle of the day, evenings or weekends, and has the potential to reduce the level of subsidy that is required to operate the route.

In addition to growing the existing PSO, Welsh Ministers also have ambitions to increase air connectivity from Wales to other economically important parts of the UK. As such, officials have been working to develop an economic case for a suite of new PSO air services linking Wales to wider parts of the UK such as Scotland, northern and eastern England, and London. In preparing for Brexit, we must make every effort to put Wales in a strong economic position. 80% of Welsh exports are to the rest of the UK, so it is vital that we make travelling to other parts of the country fast and convenient in order to support Welsh businesses. The Cabinet Secretary for Economy and Transport will be making a statement on the proposed new PSO air routes shortly.

The latest contractual position is set out in Section 2.

Securing a more robust and resilient airline to operate the route

It has become clear that the long term success and stability of the PSO requires a larger, more robust and resilient operator to be secured. The Welsh Government secured (under a short term contract) such an operator in Eastern Airways, which is a Type A licence holder.

In aviation terms, there are two types of licence holders - Type A and Type B. Type A licence holders are able to operate large aircraft, and are robust, stable businesses which are rigorously regulated (including financially tested) by the UK aviation regulator, the Civil Aviation Authority (CAA). Type B operators are typically small, financially susceptible airlines with private ownership and a small fleet of small aircraft. The CAA does not regulate Type B operators to the same degree as it does for Type A operators.

Prior to Eastern Airways taking over the PSO in March 2017, the Welsh Government had previously contracted Type B operators to deliver the service. This was largely due to the size of aircraft required to operate at Anglesey, but cost was also a factor. It is considered that having a Type A airline operating the PSO would bring significant long term benefits and opportunities which have not been available in the past. Eastern Airways has already achieved significant progress in increasing the number of passengers using the route (an increase of around 40% when compared to the previous year) and has secured an 'alliance arrangement' with Flybe to bring other passenger benefits such as code sharing opportunities and wide ranging visibility on booking systems.

Growing the route and increasing aircraft capacity

Over the last 12 months Eastern Airways has stabilised the route, re-established passenger confidence and successfully increased patronage by almost 40% when compared to the

previous year, demonstrating that when a larger, well established operator is running the route, there is clear potential to expand the PSO. Successes from the last year include

- The annual average load factor during 2017/18 was 79%, compared to an average load factor on other Cardiff domestic routes of 65%.
- 13,845 passengers were carried on the service; an increase of around 40% when compared to the previous year. We are now seeing passenger numbers comparable to those recorded when the service first launched 10 years ago when passenger numbers were at their highest.
- During 2017, 94% flights departed on time or within an hour of their scheduled departure time. The average delay for the PSO was just 11 minutes; compared to an average delay on other Cardiff flights of 15 minutes.
- During 2017/18, 97% of flights operated. Out of the 23 cancellations, 8 were due to technical reasons and 15 weather related issues at either Cardiff or Anglesey.

The forthcoming tender will be seeking to achieve growth on the route, flexibility in delivery and service enhancements. We will ask the market to respond suggesting how best to meet these aspirations.

Anglesey Airport Security Arrangements

Increasing the security arrangements at Anglesey Airport is an area where benefits could be achieved. Benefits could include:

- The ability for the operator to use a larger aircraft, which would carry more passengers; and
- The ability for passengers to arrive 'clean' at Cardiff Airport and go directly to their connecting flight rather than having to disembark at arrivals and to go back through check in and security for any onward travel.

It is understood that both capital investment at Anglesey Airport and a variation to operational procedures at the airport would be required to achieve compliance with the relevant Department for Transport's security arrangements and hence secure the associated benefits.

The Welsh Government has committed to investigate this option further, and will consider if, and how, any appropriate investment might be made. In this respect, we will engage a key stakeholder group to work collaboratively in order to make any future decisions pertinent to Anglesey Airport. Stakeholders include Anglesey Council, the airport operator, the MoD (at RAF Valley), Cardiff Airport, the CAA, and the Department for Transport in UK Government.

SECTION 2: Clarification of the current contractual position.

The Cardiff – Anglesey PSO has been subject to a number of well-publicised failures which most recently put the service under an immediate threat of closure. In order to mitigate this threat, we took a risk based approach and immediately replaced the failing airline with the current operator, Eastern Airways. Eastern Airways was our primary choice due to it being the second suitable bidder from the February 2016 tender (which was won by Van Air). No formal

expressions of interest have been received from other airlines in respect of operating the current Eastern Airways contract.

Due to the urgent and unusual circumstances which gave rise to the contract with Eastern Airways we put in place an emergency 1 month rolling contract. The airline operates a twice daily service between Cardiff and Anglesey enabling business trips in both directions. The contract provided Welsh Ministers with time to consider the future of the PSO and mitigate similar operator failures going forward. Ministers have the ability to terminate the temporary contract at any time – in effect this will be when the new contract is in place.

Over the past six months, we have been pursuing a derogation of security regulations at Anglesey Airport and have been in contact with both the CAA and Department for Transport. The derogation has the potential to bring significant benefits to the PSO by allowing aircraft weighing up to 15 tonnes (rather than <10 tonnes) to fly in and out of Anglesey. This would allow a circa 30 seat capacity aircraft to be used on the route – resulting in around a 50% increase in available passenger seats, which in turn would encourage sustainable growth and fulfil the increase in passenger demand that Eastern Airways has experienced over the last 12 months. Approval of the derogation would enable the more substantial (Type A) airlines to bid for the service. As such, we made the decision to postpone the procurement while we explored this further.

Unfortunately officials have recently been informed that the derogation will not be granted. Whilst this is extremely disappointing, it has now given us clarity and we are now preparing to procure a new 4 year contract for the service. It is anticipated that the procurement will be launched in June. The procurement will seek to secure a long term operator with a view to ensuring the growth aspirations for the service are realised. The procurement will take a minimum of 6 months to comply with mandated time scales. We will advise the Committee when the tender has been launched.