

Deputy Charles Parkinson
President – Committee *for* Economic Development
Raymond Falla House
Longue Rue
St Martin
Guernsey, GY4 6HG

18th June 2018

Dear Deputy Parkinson

States of Guernsey – Review of Air Transport Licensing P2018/62

As a long term, philanthropic, supporter of our local economy, I entirely share the Committee for Economic Development's (the Committee's) aspiration to drive and deliver sustainable economic development, growth and diversification. I feel compelled however to urge reconsideration of the proposals detailed in the above referenced paper of 11th June 2018 in respect of air route licencing.

I firmly believe these changes would be both highly perilous and destructive to Guernsey's future airlinks and their sustainability.

Please permit me to give a little historical context before proceeding to my reasoning.

Since 2004 I have continually invested in developing and evolving the Blue Islands airline business from an Alderney based operator of 2 Islander / Trislander aircraft, to the 5 ATR operator that it is today, operating some 580,000 seats per annum to and from our Channel Islands. This business has required in excess of £45m of personal investment, well outside the context of a typical investors rational investment criteria.

I have done this because I want Guernsey's economy to prosper.

Over the years, we opened routes to Paris, Geneva, Zurich and Amsterdam. They all ceased to operate because our incoming tourism industry could not sustain these operations and the outbound travel requirements of our communities were just too small to warrant these routes. So, I speak with some authority and knowledge of operating an airline business serving the Channel Islands.

We base our entire fleet exclusively in the Channel Islands, providing the greatest level of operational resilience in times of inclement weather disruption and this results in the retention of some 100 locally based employees. Would newcomers do the same?

The need for licencing

I am of the firm belief that in sub-scale markets, such as the majority of those to and from Guernsey, unfettered competition is not in the best interest of customers or the economies that air services connect.

Rather, our current route licencing structure, with requirements on licence holders to operate sufficient flights to sustain frequency of service, is the best way to safeguard the islands' connectivity.

Blue Islands understands that roughly a third of seats operated to and from Guernsey are empty. This shows the commitment of the current operators to ensure a level of schedule frequency and service level above purely commercial considerations.

I emphasise again that we must all be fully aware of the law of unintended consequences.

Please allow me to provide some possible adverse results of an open skies policy.

- 1 It is not uncommon for year-round scheduled services to lose money during the quieter winter months, a situation that is only tenable through strong performance in high summer. In an open skies scenario, an operator could begin to fly Manchester, Bristol and other Aurigny routes at peak summer times only with no requirement to operate year-round. This additional competition would undermine Aurigny's performance during this period and jeopardise the summer season profitability required to support their year-round schedule. Aurigny could then be forced to reduce their year-round frequency to mitigate their losses in the quieter season and placing the year-round connectivity that islanders currently enjoy in danger. An alternative of course, would be for Aurigny to seek to extract further profits from the Gatwick market to offset losses on other parts of their network.
- 2 If another carrier came in on the Guernsey-Southampton summer market, we would likely remove our mid-day frequency. Our aircraft hours could then be used to operate other routes, such as Manchester and Bristol discussed above, but to what net benefit to Guernsey? We would also cease to operate loss making winter sectors once again placing the year-round connectivity that islanders currently enjoy in danger. This is a concern on Southampton where a significant number of residents and visitors alike rely on high frequency, year-round connections to the mainland to reach the rest of the world.
- 3 If another significant carrier came on the Guernsey-Jersey route at peak times, where both Aurigny and ourselves used to lose unsustainable amounts of money, Blue Islands would no longer be obliged to maintain its flight frequency. It would therefore cut unprofitable flights at times when there is low demand such as the middle of the day, thereby reducing Guernsey's connectivity and frequency.

- 4 Guernsey is so fortunate to have two indigenous carriers who are willing to lose money for the sake of their Island, however this willingness has limits. Both Eastern Airways and Airline Investments Limited (the parent company of Logan Air and bmi regional) announced big losses in their most recent financial statements. The regional market is over saturated and it is only a matter of time before significant consolidation and rationalisation occurs.

The potential contra-implications of an open skies policy are clearly demonstrated in recent changes on the Guernsey to Jersey market. An unrestricted (in terms of both maximum and minimum service provision) licence was granted to Waves to operate this route earlier this year, however at the time of writing there are two further developments. Firstly, Waves has recently announced that it has cancelled all services for some 3 weeks as its aircraft is undergoing maintenance. No alternative aircraft was sourced to cover the operation and passengers were left with the option of changing their plans, requesting a refund or travelling with an alternative operator.

Secondly, Blue Islands has applied for a variation to its own licence to remove any minimum frequency or capacity requirements, in order that it can reduce its own flying to compensate for the lost revenue caused by Waves' entry to the market.

This scenario fully demonstrates the risk of an "open skies" approach. Waves may not have been so quick to cancel all its services if its licence was predicated on a minimum service level. Furthermore, Blue Islands would not be forced to taper back its own services had unsustainable competition not been permitted in a marginal market. While likely that Blue Islands are currently able to accommodate those passengers dropped by Waves, it is possible spare capacity would not be available if Blue Islands was operating a reduced schedule.

The proposed approach

The Review proposes that only Gatwick and Alderney will continue to be licenced and therefore be afforded protection from predatory competition. It is unclear how this approach is congruent with the objectives set out in 8.5.5 of the States of Guernsey Economic Development Strategy (P.2018/48), particularly the objective of ensuring sustainability. As discussed above, the deregulation of air route licencing will almost certainly (as seen in the Isle of Man) lead to operator's cherry picking soft target routes on a seasonal basis to best suit the optimisation of their own business. We could see predatory behaviour on key routes such as Manchester and Southampton, resulting in a short term booming of capacity (and perhaps to short term reductions in fares to unsustainable levels below cost) and the subsequent 'bust' of a market participant at the point when losses become untenable. Thus, this approach serves only to undermine the number of sustainable, year-round regional services, operated by any carrier.

Bizarrely, the largest route to be protected, London Gatwick, is profitable, the least vulnerable (given slot restrictions) and operates at an annual load factor of circa 80%, a load factor likely to suppress market growth in times of peak demand on such regional services.

However, this protection is understandable given a desire to ensure an appropriate level of service on the Gatwick route and to reduce losses incurred by the tax payer through Aurigny. However, an open skies policy will increase Aurigny losses if they face competition elsewhere on their network as discussed above. Our losses would also increase if we were to face increased competition and we would then be forced to cut schedules and consider changing our corporate position.

Given the suboptimal Guernsey load factor on most routes and the requirement to maintain sustainable airlinks, I would urge the Committee and the wider States of Deliberation to consider retaining the current licencing safeguards for our population of just 60,000. Air transport providers' objectives are, I assure you, entirely aligned with those of your Committee.

However, until such time as we see exogenous changes such as population increases, hotel bed stock increases, a repositioning of 'product Guernsey' in the inbound tourism sector and an increased propensity to travel from local residents, these licencing safeguards are essential if Guernsey is to maintain the year-round network of services that it enjoys today.

The constant comparison to Jersey is fundamentally flawed, Jersey's population is 66% larger than Guernsey's (some 42,000 residents). This relative difference is felt acutely when both markets are sub-scale. A straight comparison between these two markets is clearly not appropriate. Even if one deems the open skies policy in Jersey a success, there is no reasonable grounds on which to expect a similar policy in Guernsey would meet with the same success.

Licencing was designed to ensure adequate service provisions whilst providing growth opportunity in such a manner that provided comfort to enable the investment in the airline infrastructure, such as my own in Blue Islands, required to develop such routes. You will, via Aurigny, understand that operating air services to sub-scale demographics is a costly business and that uncertainty is counter-productive and reduces investment levels.

Much like the approach to appraising the investment case of a runway extension, these decisions must be based on evidence. I see no evidence to suggest that the current licencing regime (the Transport Licencing Authority's application of this regime aside) discourages route development. That must be stimulated by different imaginative proposals that the Committee must bring forward. We have a current scenario where our supply exceeds demand. As such, it is the demand point that requires further study and action, not the removal of moderated safeguards without basis or evidence. We are not aware of any credible evidence that suggests that the removal of a competently managed licenced environment would incentivise any airline to operate any new services.

There are other examples, but the gist of my argument is that licencing allows our government to dictate levels of service on a year-round basis. If this system is lost then the outcome will be terribly detrimental, if not disastrous, to our air services, connectivity, sustainability and frequency of service for our Guernsey customers.

My team at Blue Islands welcomes the work on the wider review of 'product Guernsey' and values the opportunity to engage and work collaboratively in identifying the actions required to re-stimulate current day demand for a reformed product. We have grave concerns for the future structure of our business should 'open skies' be progressed at a time where capacity is not the limiting factor, and air route connectivity and air fares are anecdotally compared to utterly different and larger markets.

I can well imagine that our concerns will also be shared by the executive at Aurigny, who currently enjoy an operation entirely free of direct competition, yet still make a significant loss for reasons you are fully aware of and some of which we have outlined here.

I urge you to consider the likely contra-implications I am raising here as a local resident, investor and supporter of Guernsey PLC, and revisit the recommendations. It is vital that we work together to deliver tangible and sustainable economic growth, avoiding the unintended consequences of inadequately appraised structural change.

My team and I would welcome the opportunity to make further representations to your committee at the earliest possible convenience to avoid **a future nightmare scenario for Guernsey.**

Yours sincerely

D S Coates
Chairman