

## **Open letter to the Deputies of the States of Guernsey**

6 July 2018

Dear Guernsey Deputies

### **Review of Air Transport Licensing (P.2018/62)**

The proposed Review of Air Transport Licensing (P.2018/62, “the Review”) put forward for consideration in the States of Deliberation at its July 2018 meeting by the Committee for Economic Development (“the Committee”) represents a significant shift in the Guernsey air transport environment. Blue Islands has highlighted to the Committee, both in writing and in person, that there are huge risks associated with such an approach.

Deputy Dudley-Owen is quoted in the Guernsey Press (22 June) as stating “it is hoped this approach will facilitate new route development”. It is of deep concern to Blue Islands that a fundamental change in policy on a subject of such great importance as connectivity should be based on hope alone.

Blue Islands is grateful for the opportunity to discuss our concerns with the Committee, though this engagement has only confirmed that there has been no meaningful, quantifiable analysis of the proposed move and no scenario planning and “hope” appears to be the only basis.

Having now exhausted all avenues available to us to prevent what would be, in Blue Islands’ view, a potentially disastrous change in policy, we now write to all deputies in the hope that our perspective may assist the States of Deliberation in their appraisal of the Review.

### **The main aims of scheduled air services**

In addition to affording Aurigny enhanced protection on the London Gatwick route, the existing Air Transport Licencing Law 1995 Policy Statement (“Policy Statement”) of 2013 outlines 7 main aims in respect of Scheduled Air Services.

These are all maintained in the proposed revision to the Policy Statement attached as Appendix 2 to the Committee’s Review, apart from an addendum to aim 7. It is quite clear that the proposals set out in the Review are utterly inconsistent with all of these aims, with the exception of aim 7 of course, given the continuation of extraordinary protection being granted to Aurigny on London Gatwick.

These aims provide a useful structure to the discussion, I address each aim in turn below:

1. Maintain year-round scheduled services of sufficient capacity to cater for all user categories;

and

2. Secure provision of sufficient capacity throughout the year to cater for the needs of the tourism industry;

I will not restate the concerns raised in our Chairman's open letter of 18 June in full, however I would say again that opening the vast majority of routes to predatory competition risks undermining the year-round service provision to the point where frequency must reduce, fares must rise to compensate for lower volumes or (most likely) both. I would also re-iterate that we believe a third of seats operated from or to Guernsey Airport are currently empty and it is therefore unclear how the proposed revision does anything to further these aims.

I note the suggestion by Deputy Dudley-Owen in the Guernsey Press (22 June) that the fact Waves were ultimately granted a license by the Transport Licensing Authority (TLA) to operate to Jersey means that the licensing regime is not fit for purpose or fails to provide any safeguard for incumbents. This simply does not follow. Whether or not one believes the TLA has discharged its duty under the law appropriately or not is irrelevant to the wider consideration of the licensing regime as a whole. What is clear is that the role of the TLA is vastly complex and we would question whether it is suitable for such a technical function to be mostly comprised of laymen. Furthermore, in the specific case of Waves, it is clear that they have failed to provide a robust service with a recent suspension of services for some 3 months.

3. Secure the lowest fare structure consistent with viable operations;

As noted in our Chairman's letter of the 18 June, the appearance of a predatory competitor on any given route may well lead to a short-term reduction in fares as airlines wrestle for market position. I assure you however, these fares would not be "consistent with viable operations". You may well achieve a short term "booming" in capacity and availability of fares offered at below cost but this will not last and the service provision that emerges following the "bust" of one or other operator may very well be more expensive, lower frequency and of a reduced quality to that which existed before as the surviving operator seeks to recoup the losses incurred in establishing that position.

Guernsey is currently fortunate enough to be served by three significant operators on a year-round basis, Aurigny, Flybe and Blue Islands. Aurigny recently announced losses of £5.2m for 2017, Flybe recently announced losses of £20.5m and Blue Islands has required in excess of £45m investment to date. One must question then on what grounds the Committee believe the current framework is failing to deliver on this objective.

The States could very easily move the bar when it comes to the fares required to operate viably from Guernsey by adjusting the airport landing fees and charges. The States have the tools to make a meaningful change to the fares available from and to the island if the will, and funding, is there. I discuss this point further below.

4. Obtain continuity of service from year to year, with the airline or airlines operating on a route being in a position to develop the service for the benefit of all categories of user;

Clearly, continuity of service would be undermined by predatory competition, this hardly needs further comment. The “development” piece warrants further consideration however. Surely “development” would consider first and foremost the feasibility and sustainability of such services.

Generally speaking, in order to “develop” any given service significant investment will be required. By way of example, this could be through upgrading the aircraft used (perhaps larger capacity), opening new sales channels, investing heavily in marketing and employing additional crew to enhance resilience. The current licensing regime provides an element of comfort to any operator serving Guernsey when it comes to investment appraisals which would be utterly removed by the Committee’s proposals.

As an illustration, aircraft leases tend to have a term of 5 years or more, typically 7 or 8. Of course shorter terms exist, but an operator will “buy” that increased flexibility through higher rental payments that are ultimately passed on to fare paying passengers. In the current licenced environment, an operator may choose to bring in an aircraft to operate one or more routes to or from Guernsey, encouraged by the knowledge that their investment risk is diminished by a safeguarding of their position on the routes served. In an open skies scenario, an operator may well be dissuaded from making such an investment as there would be nothing to stop another operator becoming predatory and undermining the investment case once the market had been established.

An example of a recent experience is work on a proposal with my team at Blue Islands to invest in an additional aircraft and crew to bring a new clutch of year-round routes to Guernsey, namely London City, Dublin and Luton. Ultimately, this opportunity was declined by the Committee, as is their right. We made a request for financial support given that the clutch of routes was unlikely to self-sustain in the short term. Our risk sharing proposal / funding request was refused. I assure you, our appetite for this opportunity would not have been so great in an open skies scenario where there would be nothing to stop a seasonal, predatory competitor demolishing any prospect of the route development breaking even.

In this way, I would suggest that the proposals will, most likely, achieve the exact opposite of this aim. It is curious to me that the Policy Statement already seems to recognise the development point, but only in relation to London Gatwick at 18.1(i) which states that consideration must be given to “*the investment by the incumbent operator(s) on the route*”.

#### 5. Facilitate point-to-point travel and interlining opportunities;

I see no evidence to suggest that the current policy is prohibitive to point-to-point travel or interlining opportunities, this appears to be supported by the findings of Frontier Economics (see below). Both of these may however be undermined by the proposals as discussed elsewhere.

Taking Southampton as an example, through the Franchise arrangement with Flybe visitors and residents alike are currently able to book through tickets, under a single transaction and booking reference, to the wider Flybe operated network of routes by travelling via Southampton. Currently, some 10% of the total traffic on services between Guernsey and Southampton are connecting to other flights with Amsterdam, Dublin, Edinburgh and Glasgow accounting for the majority of the ultimate destinations. These connections are only achievable given the high frequency of Guernsey to Southampton services operated by Blue Islands, and the seamless connections available only by virtue of the Franchise. Another operator joining the route would, more than likely, result in Blue Islands reducing its own services diminishing this connecting travel option.

Over recent years, Blue Islands has launched direct services to Paris, Amsterdam, Zurich and Geneva. Over the duration of these operations, Blue Islands invested significantly in not only promoting the routes but also by sustaining losses on these routes in an attempt to establish them. Ultimately, we learnt that passengers preferred to travel to a UK hub airport, that was serviced with a high frequency service, from where they could travel to any of these destinations, with a number of carriers, at a number of times, as part of a much larger service provision without the same economically debilitating sub-scale factors inherent with Channel Islands markets.

Crucially, Blue Islands did not need an air route licence to operate any of these European routes. Route licencing is not a present requirement for direct European routes; hence there is nothing other than the economic viability preventing or deterring any airline operation from launching such services.

#### 6. Secure the highest possible standard of service;

I fail to see how this aim is furthered by the Committee's proposals. It is clear however that this aim could be threatened. Guernsey currently has two indigenous operators with aircraft and crew based in Guernsey, an incredible position for an island of some 60,000. This allows for the greatest possible resilience in times of disruption, be it weather, technical or crew sickness among others. For these operators, Guernsey is a central home market. Would other potential operators provide the same resilience, or would Guernsey be a small part of a wider network, dropped in favour of larger and more profitable opportunities elsewhere on the network? Is this a risk worth taking?

I would encourage all Deputies to read both Deputy Peter Roffey's column in the Guernsey Press (21 June) and Peter Gillson's comments (28 June), which provide real life, highly credible examples of the unintended outcomes I discuss here.

## Frontier Economics' advice – the need for open skies

While the Committee has the benefit of the full Frontier Economics report, the summary we have access to notes *"In addition, some airlines have been granted air route licences to operate a route but then do not, suggesting that the licencing process is not the main or only barrier to route development"*. This appears to have been discounted by the Committee though it is unclear why.

Aurigny currently hold a license to operate flights between Guernsey and Jersey and Flybe currently hold a license to operate between Guernsey and Southampton. Neither operator elects to make use of these licenses. This is because both of these routes have, in recent years, gone through the very "boom and bust" cycle that I reference above and the simple fact is it is not in their best commercial interest to utilise these licenses.

Furthermore, Frontier Economics found *"Most airlines we consulted were satisfied with the current process"*. It is little wonder that Low Cost Carriers (LCCs) say they would be deterred by anything but the 'lightest touch licensing regime' as only this type of regime would allow the predatory cherry picking of routes based on optimising network wide profitability which is fundamental to the LCC business model. This would not be in the best interests of the market in terms of ensuring the retention of year-round, scheduled services of ample frequency.

Even if it were concluded that the risks of an open skies approach were outweighed by the potential benefit of bringing an LCC to the island (a conclusion I would challenge), why would you elect to remove route licensing when there is no evidence that the only subset of operators suggesting this may be a good idea are likely to operate to such a sub-scale market (with limited latent inbound demand) without significant financial incentive.

I am utterly mystified then as to why the Committee views the removal of route licensing as a meaningful or required step forward when a raft of other options exist to make a meaningful change to the environment.

## Alternative approaches

Government clearly has a part to play in moving the situation forward yet what we have seen over recent years is a series of reviews all designed to guide and inform government policy but all of which, by virtue of a further review swiftly following, fail to make a material impact or set out a defined strategy able to carry the community with it.

Despite the political inertia, I personally commend the steps taken by Aurigny recently to drive their business forward for the benefit of the community such as introducing a more flexible pricing policy or working to secure a distribution agreement with EasyJet. For Blue Islands part, the Franchise agreement with Flybe unlocks huge sales and distribution potential while providing cost side synergies in order that we can, to use the words of the Policy Statement, offer the lowest fares consistent with

viable operation. We have also replaced two of our forty-six seat ATR-42s with sixty-eight seat ATR-72s since 2016.

The States of Guernsey have an enviable amount of control when it comes to air transport links. They own an airline while having a second indigenous operator keen to work more closely with them, they control the airport and manage air route licensing. I can think of no other jurisdiction with this suite of tools and yet we continue to see no assimilation of the net output or meaningful action but rather a continuation of conflicting stakeholder objectives. The latest set of air route licensing proposals does nothing but remove a tool in government’s arsenal, on what appears to me to be a baseless hope that something beneficial might happen.

What then could government do to deliver a real change to services provided from or to the islands?

### *Airport charges*

The charges levied by Guernsey Airport on commercial air transport operators are split between a per passenger variable charge and a per aircraft movement landing/take off charge.

At the time of writing, Blue Islands is charged £5.41 for every passenger moving through the airport from or to the UK which falls to £3.78 for every passenger moving from or to another point in the Channel Islands.

In addition, each time an aircraft lands at or takes off from Guernsey on an operation to or from the UK, a charge of £221.03 is levied on Blue Islands for the larger sixty-eight seat aircraft and £163.37 for the smaller 46 seat aircraft. This falls to £122.59 and £90.61 respectively if the operation is from or to another point in the Channel Islands. If one attributes the “per aircraft movement” charges to a “per passenger” basis on the assumption that some 66% of seats are full (which we believe to be the average at Guernsey Airport), the current per passenger charge is as follow:

Aircraft Type	Total Guernsey Airport charge per passenger	
	46 Seat	68 Seat
From/to UK	£10.86	£10.43
From/to Channel Islands	£6.80	£6.57

*Figure 1: Guernsey Airport fees and charges allocated per passenger*

For departures to and arrivals from the UK, using Blue Islands larger aircraft type, Guernsey Airport charges in the region of £11 for every passenger. Clearly, this charge must be recouped from fare paying passengers. Blue Islands would pass any reduction in this charge directly to the passengers and would commit to doing so.

A full or partial waiver of airport fees would clearly result in a cost to the tax payer as the reduction in Guernsey Airport revenue would lead to a higher subsidy requirement. However, this would result in a material change to the fares operators could offer. Furthermore, this change could be implemented in a matter of weeks and would serve as an excellent test case of the elasticity of demand, by route, in a real world setting.

#### *License conditions*

The Committee seems satisfied that, in the case of London Gatwick, an appropriate suite of performance indicators can be found which can be attached to a licence and provide comfort to the States, as representatives of the people of Guernsey, that the current service provision is of sufficient quality to safeguard the current market state.

It would seem eminently sensible to consider expanding this approach to other routes, those which have a recent history of being unable to sustain meaningful competition over the long term such as Southampton, Manchester and Jersey. This would seem a more reasonable approach than throwing caution to the wind, on the basis of no evidence that I can see, in the hopes that improvements will come with no consequences.

Clearly there is a balance to be struck here, though I confirm that Blue Islands would commit to exploring this option with the Committee. Again, this suggestion pre-supposes a reaffirmed, clear framework and adequate resourcing of the licencing authority.

#### *Route specific discrete support*

As was gratefully received in the case of the Guernsey-Cardiff service launched by Blue Islands in 2017, the Committee could elect to support new routes through direct financial subsidy. There is also no reason whatsoever that a subsidy could not be provided to an existing route that, in the Committee's view, had growth potential if the fares charged were lower or frequency/capacity increased.

The cost of any of the above options would need to be appraised and set against the potential economic benefit to Guernsey as a whole. The benefit would also be felt by the resident population and while this may not represent a quantifiable economic reward it is of clear importance.

#### **Conclusion**

Transport remains one of the highest priorities for all sections of our community and, I agree, is crucial to the wider economic prosperity and wellbeing of our island. Operators are routinely chastised by politicians, industry bodies and the public for charging too much, providing an inadequate service or stifling economic growth while continuing to lose millions of pounds a year in the attempt. I whole heartedly support action to move away from this toxic and damaging state of play though aspirations do need to be tempered with reality.

I fear that the Committee, doubtless with good intentions, has identified a cost neutral (in terms of immediate government outlay) change that has not been appropriately assessed in the hopes that this will somehow fix the fundamental issue which is the sub-scale nature of the Guernsey market.

I ask all deputies to please consider the following questions when appraising the Committee's proposals:

1. What evidence does the Committee have to suggest that making the majority of routes exempt from the requirement to hold a licence will encourage development and innovation?
2. Which routes from Guernsey would remain financially viable and could sustain the financial damage caused by predatory 'cherry-picking' in an open skies environment?
3. What assessment of the risks posed to the continuation of existing services has been undertaken by the Committee?
4. What is the evidence that the current licensing regime discourages or prevents competition? Blue Islands competed with Flybe on Southampton and Aurigny on Jersey for several years under the existing regime. Competition and moderated appropriate safeguards through licensing are not mutually exclusive.
5. If competition on a route was introduced, how long would the operators sustain losses and what would prevent them from cherry-picking seasonal peaks, without any commitment to operate year-round services?
6. Does the Committee's proposal recognise the benefit of having locally based operators with locally based aircraft and crew?
7. If Jersey is, as stated by Deputy Dudley-Owen in the Guernsey Press (22 June) not "critical" for Guernsey in the same way as Gatwick, why is this route under as much scrutiny, if not more, than Gatwick? Why would the Committee underwrite a ferry operator for the summer season? Furthermore, why would the Committee need to underwrite a ferry operation, mode of transport aside, if the market did not meet the criteria given in the Review for a lifeline route (i.e. requiring government intervention).
8. What evidence does the Committee have to show that the current services are the limiting factors that are suppressing demand?

All passenger types, be it local residents and businesses or potential visitors to our beautiful isle would like to see “more for less”, lower fares and more flights to more destinations. This is completely understandable, though not achievable in a sub-scale market where demand is the limiting factor as is the case with Guernsey.

In the absence of any tangible evidence in support of the approach and without consideration for sustainability or the unintended consequences we have raised, I urge all Deputies to consider whether the Committee’s proposal has been sufficiently appraised. At the very least, further impact analysis of the various outcomes of this policy should be made available to Deputies in order that a reasoned decision can be made.

Yours sincerely

For and on behalf of  
**Blue Islands Limited**



R Veron  
**Chief Executive Officer**