

Adran yr Economi, Gwyddoniaeth a Thrafnidiaeth
Department for Economy, Science and Transport
Cyfarwyddwr Cyffredinol • Director General



Llywodraeth Cymru
Welsh Government

Darren Millar AM
Chair
Public Accounts Committee

23 May 2014

Dear Mr Millar

Public Accounts Committee – Intra-Wales – Cardiff to Anglesey – Air Service

I am writing to follow up on your letter of 2 May requesting further information on the North South Air Service.

I have enclosed a document which attempts to do this as fully as possible. Please let me know if you require any further information.

Yours sincerely

James Price



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Welsh Government response to the letter from the Public Accounts Committee, dated 2 May 2014.

Following the evidence provided at the Public Accounts Committee on 25 March 2014, the Public Accounts Committee raised a number of queries. The Welsh Government provided a response to each query raised in a letter dated 23 April 2014. The Committee is seeking further information and clarification from the Welsh Government. This document provides responses to each query raised and seeks to provide the clarification required.

1. The Committee sought further explanation about the changes in state aid rules affecting the PSO subsidy and the additional flexibility that these changes may provide should the Welsh Government decide to continue its subsidy of a North/South Wales Air Service beyond December 2014. Your response does not articulate the specific changes in the rules, nor does it make clear the additional flexibility that the new rules may offer for any future Air Service contract. We request further detail on these matters;

Welsh Government Response:

The European Commission's 2014 Aviation Guidelines provide further clarification to state aid rules for PSO's when compared to the 2005 Guidelines. This has given greater certainty and therefore fewer constraints in the Welsh Government's approach to the planning of a potential future service. Should the Welsh Government continue to support the Public Service Obligation Wales Intra Air Service, this will aid any tender process. Bidders will be required to provide innovative responses to explore additional routes and consider the reduction of current contract downtime.

Greater flexibility is now also available in other areas, such as operating aid. "Operating aid" means funding to cover costs that a company could expect to pay in the normal course of business, such as rates, rent and utilities bills.

For example, hypothetically, a new PSO Cardiff–Anglesey return service could run twice daily (at the beginning and close of each business day, Monday-Friday). With this service, the aircraft would sit stationary throughout the day incurring hours of continuous downtime. To utilise the aircraft and reduce downtime, an additional, commercial service could be offered; for example, Cardiff-Paris - taking advantage this downtime with the assistance of operating aid.

2. The Committee requested a detailed breakdown of the data the Welsh Government is gathering to inform its decision on the future of the Air Service if not specified by, or separate to, the Terms of Reference for the work being undertaken by ARUP. The Committee's request specified a number of areas on which data might be collected. The response states that these are identified in the Terms of Reference for the Review of the Intra Wales PSO Air Service being undertaken by ARUP as attached at Annex B of the response. The Committee did not feel that the detail contained in this Annex answered our request sufficiently. While it set out the key areas being considered by ARUP, the information provided in the Annex did not specifically state what data the Welsh Government is gathering to inform its decision on the future of the Air Service. We request further detail, including confirmation of whether the Welsh Government is gathering the data necessary to address the specific points raised in our original letter;

Welsh Government Response:

ARUP is undertaking a review to provide advice to Welsh Government on the best solution for determining a future air service for Wales. We intend this research will include:

- identifying the role that the air service could play in the Welsh Government's strategy for Cardiff airport
- identifying synergies between the air service and other developments (such as the Energy Island)
- a better understanding of the journey purposes of users of the service and their overall catchment area
- a better understanding of service users, both private and public sector, through analysis of demographic data (where the information is available)
- identifying the perceived advantages of the service against other modes of travel
- exploring options for alternative commercial approaches to the air service in order to establish the likely subsidy requirement for continuing services beyond 2014
- undertaking primary research to establish the importance that businesses place on the air service
- to understand whether any negative economic impacts could be expected in the event that the service is removed
- exploring different, viable, route options and connectivity

A benchmarking exercise against PSOs elsewhere in the UK/Ireland has already been undertaken and forms part of the initial review previously undertaken by ARUP.

3. The Committee asked for confirmation of the timetable by which the Welsh Government expects to determine the future of the Air Service, including the timescale for the possible re-tendering exercise and the contingency arrangements should the tendering process fail to identify a suitable provider.

Regarding the timetable, the Committee would welcome confirmation of: when the Welsh Government expects to make a decision on whether to go out to tender for a new Air Service contract; when any subsequent tender process is likely to commence; and when the tendering process would be completed (assuming that there is a need to allow sufficient time in advance of the expiry of the current contract in the event of a change in contractor).

The Committee would also welcome confirmation of the role that the second phase of work being undertaken by ARUP will play in the Welsh Government's decision on whether to go out for tender for a new Air Service contract. The 'six-month' tendering process referred to in your previous response, combined with the expectation that the ARUP work will be completed in July 2014, suggest that the ARUP work will not be completed in time to fully inform that decision.

Your response appears to refer to how contingency planning requirements would be built into any new Air Service contract. The Committee was concerned about the contingency arrangements should any tendering process fail to identify a suitable provider. In such circumstances, we welcome confirmation of the scope of any action that the Welsh Government might be able to take to continue the service in the short-term, and information on how you expect to be able to secure value for money from such arrangements. We note that the Welsh Government found itself in the same position in early 2010. The Auditor General's memorandum indicates that the Welsh Government received legal advice at that time indicating that a contract extension would have breached procurement regulations. Legal advice also questioned whether the 'emergency procedure' provisions within the PSO rules could be satisfied and noted that there were various risks in taking forward an interim contract;

Welsh Government Response:

An early phase of ARUP's work into the review of the air service will be used to form advice to Ministers on the future of an air service in Wales. The full report will be provided by ARUP to Welsh Government by July.

In line with timescales for a full OJEU tendering exercise, the Welsh Government, if it decides to procure a new air service, would ensure any potential procurement exercise is underway by the end of the summer. The existing contract comes to an end on 9 December.

The Welsh Government currently anticipates sufficient market interest to potentially hold a procurement exercise for a future air service in Wales. At this stage, we envisage any potential procurement process would be completed in time for a new contractor to provide a service following the expiry of the current contract.

4. The Committee asked for a description of any action taken by the Welsh Government to promote the Air Service or to encourage additional marketing activity by the operators during the current contract term and the extent of influence that the Welsh Government has over the pricing model.

The response outlines the budget allocated within the current contract for marketing activity and what the current provider is doing. However, we would still welcome clarification about the level of influence the Welsh Government has over the pricing model. As noted previously, the Committee raised this point in the context of the different business model operated by Manx2/Citywing compared with Highland Airways that you put forward as one reason for the reduction in passenger numbers. We also note that phase 2 of the ARUP work is intended to include a 'review of fares policy'.

Welsh Government Response:

The ARUP review will include looking into a revised fares strategy, including the possibility of removing the maximum fare cap, to support maximising passenger numbers while balancing the revenue risk of the Welsh Government. It is at the service provider's commercial discretion to offer fares at or below the maximum ticket price. It should be noted that Citywing operates a different commercial model to Highland Airways, with a greater focus on a reduced revenue risk.

5. Finally, in addition to these points the Committee noted the reference in Annex A to your response to the recently opened investigation by the European Commission into compensation for Sardinian Airports.

Your response indicated that the outcome of this case should provide further guidance on what can and can't be funded by way of a service of general economic interest. The Committee would welcome confirmation of whether the Welsh Government has any indication of the likely timetable for the completion of that investigation. In addition, the Committee requests details of any contingency plans by the Welsh Government to take into account the outcome of this investigation and the impact this might have on any future Air Service contract;

Welsh Government Response:

The Welsh Government maintains contact with the EC and looks forward to receiving the report on the investigation into compensation for Sardinian Airports. At this time, the Welsh Government has received no indication as to when we can expect this decision or what it will say.

We suggest that the Public Accounts Committee might want to consider contacting the EC directly to obtain this information.

The European Commission's investigation is being undertaken completely independently of the Welsh Government, and as such it is almost impossible for the Welsh Government to gather a contingency plan and is unable to make assumptions when the content of the report is entirely unknown.