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1. Introduction

1.1 Purpose of the review

The purpose of this review is to give the States Trading Supervisory Board (STSB) – which performs the role of shareholder of Aurigny on behalf of the States of Guernsey – a position from which they are able to set targets for Aurigny.

The review is not an attempt to micro-manage Aurigny’s operations. However, Appendix 1 to this report sets out some ideas which have emerged during the course of the review, and which the STSB is encouraged to explore with Aurigny.

1.2 Background to the review

In August 2016 the Policy & Resources Committee commissioned a review of Aurigny’s objectives, building on the work on air route development undertaken by the Committee for Economic Development during 2015-16. The review panel comprises:

- Deputy Lyndon Trott (Vice-President of the Policy & Resources Committee) – Chair
- Stuart Falla MBE (member of the Sports Commission)
- Dr Andy Sloan (former States of Guernsey Economist and Director of Financial Stability at the Guernsey Financial Services Commission)
- Tim Robins (Airline pilot)
- James Dent (Alderney-based international transport economics, elected to the States of Alderney in November 2016 and currently Chairman of the States of Alderney’s Policy & Finance Committee)
- Paul Smith (member of the council of the Guernsey International Business Association)

The review commenced in September 2016, and following a request to the public, over 50 responses were received from organisations, businesses and individuals in Guernsey and Alderney. Formal meetings were held with a number of respondents in Guernsey and Alderney including:

- Alderney Chamber of Commerce
- Alderney Pressure Group
- Association of Guernsey Travel Agents
- Aurigny
- Guernsey Chamber of Commerce Tourism Sub-group
- Guernsey NED Forum
- Guernsey Taxi Federation
- Institute of Directors
- States of Guernsey Scrutiny Management Committee
- States Trading Supervisory Board
- Visit Alderney
1.3 Terms of reference

The following terms of reference were agreed by the Policy & Resources Committee. These were used as the basis for gathering evidence, which in turn provided the basis for making the recommendations in this document.

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2. Comments and context

2.1 Ownership and management

The panel’s clear view is that the only practical way forward is for Aurigny to remain under the ownership of the States of Guernsey.

It is accepted that States ownership of Aurigny is a necessary condition for maintenance of a lifeline route to Gatwick.

The panel accepts that any change in overall ownership would put at risk the access to a London hub airport through the ownership of the Gatwick slots.

However the panel believes that over time States ownership has led to a situation where, by accident and by design, air links for the Bailiwick have on occasion been managed to serve the interests of the provider rather than those of the consumer.

The panel’s view is that Aurigny, in remaining owned by the States, should support the Bailiwick’s economy and its development, and provide access to affordable air travel for the public.

The reviewers believe that Aurigny has been caught between trying to be an economic enabler and trying to operate a business with a defined financial outcome.

Furthermore, having reviewed the submission from Aurigny, as well as having met with members of the board and senior management team, the review panel believes that there should be a significant improvement in the quality and breadth of management information produced. The board needs this information for its own purposes and must ensure that STSB also has access to all information required to exercise its shareholder function.

2.2 Public Service Agreements

The panel’s view is that Aurigny should continue to provide the backbone of the Bailiwick’s network by operating the route to London Gatwick, and that economic enabler routes could be supported through a series of straightforward public service agreements (PSAs).

The support for these routes from the States should be assessed and agreed by the Committee for Economic Development, using the Future Guernsey Economic Fund.

The panel believes that this approach will also be compatible with the development of new routes following the Committee for Economic Development’s strategic air links review. PSAs can be used where necessary to support routes operated by all operators – not just those operated by Aurigny.
2.3 Aurigny’s fleet

Aurigny’s management acknowledges that its fleet is not optimal for its routes. The current ownership of the Embraer constrains the management’s ability to rationalise and optimise its fleet.

Consideration should be given to treating the purchase cost as sunk and allowing STSB to set the terms of, and undertake an unconstrained review of an optimal fleet and financing: one that could be better place to reduce costs and boost volumes, particularly on the Gatwick route.

The airline should be given the maximum flexibility to rationalise its fleet and to consider leasing options.

The review of the fleet should only be undertaken once there is a clear understanding of any agreements deriving from Public Service Agreements implemented by Aurigny.

2.4 Gatwick Airport route

It is accepted that States ownership of Aurigny remains a necessary condition for the maintenance of a lifeline route to Gatwick. The economy of the Bailiwick is highly dependent on affordable, reliable and frequent air links into and from a London hub airport.

This means that the case for government ownership is made until such point as a private sector operator can be proven to provide a similar security of links.

The panel also acknowledges the approach the States of Guernsey took to maintaining the Gatwick route following the exit of Flybe from the route.

However the panel’s view is that the approach to the provision of capacity on this route, in particular the apparent price discrimination which provides the revenue contribution to support Aurigny’s operation of its other routes, has resulted in higher prices and reduced service levels both on the London Gatwick route and also across Aurigny’s network.

The panel believes that the shareholder objectives should support moving away from this situation and as there are areas and routes where Aurigny as a business makes significant losses, these areas should be addressed directly, not through squeezing revenue on the Gatwick route.

2.5. Current objectives

The panel believes that Aurigny’s existing objectives are too specific, contradictory and restrictive. It is also the panel’s view that this has had a detrimental impact on Aurigny’s appetite to experiment with applying different pricing models that would support volume growth and economic development.

The reviewers believe that it is difficult for Aurigny to become financially self-sustaining while continuing to provide the range of services currently expected of it, and some of which it is running at a significant loss

When the States of Guernsey purchased Aurigny in 2003, the express intention of the States Report was to protect Guernsey’s long-term social and economic sustainability by securing access to a hub
London airport. This intention is reflected as an operational shareholder objective, which is implicit in the current Memorandum of Understanding between the States of Guernsey and Aurigny.

A second subsequent Memorandum of Understanding between the States of Alderney and Aurigny sets out ‘lifeline’ obligations on the routes to Alderney. This second Memorandum is however subject to the terms of the first Memorandum.

Adjusting the shareholder objectives to reflect the strategic needs of Guernsey in 2017 needs to take account of all regulatory and legal requirements, and any Memoranda of Understanding or other obligations with other parties that are in place.

It is also important that the States provides clarity on issues such as the long-term ownership of Aurigny, its future funding and what appetite the shareholder has for risk.

With that in mind the reviewers believe that Aurigny’s objectives should focus on supporting economic enablement and providing a backbone of air services to support the Bailiwick’s economy and its growth, providing access to affordable air travel to the UK.

Given that such objective will not be compatible with profit-making, the reviewers believe that the States Trading and Supervisory Board as shareholder should work with Aurigny to establish how the company can move to a sustainable operating surplus year on year through a combination of:

- Prioritisation of routes
- Targeted financial support of economically essential routes
- Reduced landing charges
- Operational and efficiency improvements

2.6 Aurigny’s current obligations

2.6.1 Regulatory requirements

Aurigny cannot operate at a loss without targeted outcomes against which their performance can be measured. Open-ended exposure to losses would be a profligate use of tax payers’ money. It might also be construed as a subsidy and/or an unfair pricing practice contrary to EU Regulation 868/2004, potentially exposing Aurigny to significant financial penalties.

Concerns about the risk of challenge from the EU for the provision of a subsidy for services being operated from Guernsey (or Alderney) into the UK may become unwarranted after the UK leave the EU; but equally, if the UK opted to continue with its existing “open skies” arrangement with the EU then the situation would be unlikely to change. It is clear that aviation policy will be a significant aspect of the UK’s discussions on exiting the EU, and this in turn could have a material impact on Guernsey and its obligation.

2.6.2 Memoranda of Understanding and other obligations

The 2003 States Report at the time of purchase also noted that Aurigny had “a long history of serving the Bailiwick on the essential inter-island routes which also need to be safeguarded”.

2
It was agreed in 2015 by the then Treasury & Resources Board that a Memorandum of Understanding between the States of Guernsey (through the STSB as the shareholder) and the States of Alderney that set out required service levels in terms of frequencies, capacities and fares, together with mechanisms for reviewing service levels would be useful. Initial agreement on this document was reached in 2016 with the intention that the agreement would be subject to regular review.

This new Memorandum of Understanding was never intended to operate as, nor replicate, a formalised Public Service Obligation upon Aurigny. It is also important to note that no requirement for Aurigny to maintain inter-island services as a formal Public Service Obligation has been put in place. Notwithstanding this, the current Memorandum of Understanding contains an operational shareholder objective to “maintain a capability to service Alderney” and acknowledges that Alderney-Guernsey is a “lifeline” link.

The assertion in the 2015 Scrutiny Committee’s Security of Strategic Air Links Report that there is a legal or financial responsibility on the States of Guernsey to provide or fund air services to Alderney is considered to be inaccurate by the shareholder. In the past a pragmatic political choice was made by the shareholder (the former Treasury & Resources Department) to support the losses on the route, but this decision neither created a formal duty nor an obligation.

2.7 Market history and conditions

Available data on current traffic on each of Aurigny’s present illustrates that:

- On all routes excluding the Guernsey-Gatwick link volumes are low
- Traffic volumes vary considerably by the time of day and season – seasonal variations are particularly striking on the routes into and out of Alderney
- When inward traffic is heavy outward volumes are often low and vice versa – this is an operational difficulty that all operators into and out of the Bailiwick have to contend with
- Traffic volumes have recently been declining

Taken in aggregate, Guernsey’s passenger volumes have not demonstrated the same growth rates in recent years as similar or near competitor markets. Pricing on many routes is mechanistic and inflexible, designed to maximise revenues rather than volumes. The reviewers were given significant anecdotal evidence to suggest that such pricing deters resident, visitor and business travellers alike. High prices may well be paid by the business traveller but at a cost of creating a reputation for Guernsey as a high cost jurisdiction. For families, the cost of holidays has increased to a level that is prohibitive for medium income groups.

The Gatwick route in particular is capacity constrained at certain times of the week and of the year, acting as a bottleneck to economic development. In such conditions it is understandable that there are those that suggest demand is inelastic.

The panel notes that one possible solution to the issue of constrained capacity could be to extend the opening hours of the airports at peak times, such as during peak holidays or sporting events, which would allow for up to an extra two rotations per day.

The panel suggests that these factors indicate that the current market is not being operated to the overall benefit of the Bailiwick’s economy. As Aurigny is the current supplier of the majority of the market, the clear inference is that its current operations are not currently and wholly aligned with the overall benefit of the island.
2.8 Competition

For many stakeholders there is a view that security of service and the introduction of competition are incompatible. It is true that to provide absolute security of the Gatwick slots ownership of an airline is required. The panel accepts that the economies of scale of many of the current routes are such that a fully-fledged market approach would be highly unlikely provide the much needed security and certainty of all year round flights.

However the reviewers believe that this focus on security has led to an aversion to considering the introduction of some aspects of competition, and of the potential benefits that a mixed market approach might bring in the longer-term.

The reviewers believe that the Bailiwick could be better served by a mixed market approach in the future combining:

- A spine of essential services provided by Aurigny, with economic enabler routes supported by PSAs
- Competitive tendering for essential and non-essential routes, with the exception of Gatwick for the reasons outlined above
- Commercial operators being encouraged to apply to enter the market to provide services over and above this spine, and for investment to be made to support further economic enabler routes where appropriate through PSAs
- Where market conditions allow in the future, and where the route is not supported by a PSA, assessing the potential for competition on economic enabler routes

This approach will lead to a market wherein States support is provided to successful bidders who can provide guaranteed capacity and slots on routes, to support objectives such as growth in passenger numbers, but where the some routes remain open to competition and new entrants. It is important that the PSAs that are put in place are clear, but also not be overly prescriptive – they must leave room for operators including Aurigny to be flexible and dynamic, and not simply become contractors to the States.

The panel also believes that in the mid to long-term the Committee for Economic Development should determine whether or not the time is right and the traffic levels are appropriate for increased competition on essential economic routes. The panel believes that at peak time Aurigny does not have the present capacity to provide services that meet market demands. Artificial restrictions on supply cannot be in the interests of the Bailiwick economy.
3. High-level recommendations

The panel is clear that the objectives of Aurigny, as a government-owned airline, must be to assist the Bailiwick in achieving economic growth and development whilst ensuring adequate social and health links. Achieving these objectives will be the justification of the ongoing investment of taxpayers’ money. The panel believes that these two objectives are achievable, and if a sustained strategic approach is adhered to then Aurigny could also move to a sustainable operating surplus year-on-year.

This can be achieved through:

1. **Focusing on increasing passenger numbers** rather than maximising revenue from seats sold.

2. **Operating PSAs to support and develop essential routes.**

   The clear public service agreement provision will work to ensure high quality reliable service, to help to protect year-round schedules, and to create certainty in in service expectations and the costs of maintaining that service.

   However the **PSAs should be open to transparent tenders consistent with Public Service Obligation routes in Europe.** This means criteria should be published, tenders invited from multiple operators, a selection panel convened to review responses, and economic incentives included in the contract to ensure good performance. In some people’s opinions these might be construed as ‘managed monopolies’ but it must be made clear that these are monopolies only in the broadest sense and will only be awarded after competitive ‘freedom of entry’ tenders.

3. **The States of Guernsey being prepared to make targeted investments to ensure that the levels set out in the fixed term PSAs are met by operators.** Conversely penalties must be put in place and enforced if levels of service in the PSAs are not met.

4. **The introduction of a simpler pricing model to encourage more passengers to fly and to ensure that flights are accessible both to islanders and to inward visitors.** In their response to the review, Aurigny said that they were willing to experiment with different pricing models to stimulate demand. The recommendation from the panel is that a simpler pricing model implemented together with other recommendations will achieve the objective of increasing passenger numbers.

5. **STSB should work with Aurigny to establish how the company can move to a sustainable operating surplus year on year** through a combination of:

   - Effective public service agreements with targeted support
   - Operational and reliability improvements
   - Revised shareholder objectives
4. Public Service Agreements (PSAs)

The panel believes that an ‘open skies’ approach, despite its potential merits, would be a model that created additional risk for Guernsey, primarily as the market is too small. If Aurigny were to operate under such a policy, it would require a very different operational ethos and, indeed, its very survival could be in jeopardy.

As noted earlier, the panel believes that PSAs for sole providers are essential for the Bailiwick’s thin routes. These should be mixed with the introduction of competition on more heavily trafficked other routes where the market conditions would allow for this. This mixed market approach should ensure that the Bailiwick is properly served and drive further improvements in customer service.

The award of any such PSA in a small market would normally be problematic. Unmanaged monopolies provide operators with little incentive to innovate or to improve efficiency. In many ways, Aurigny currently enjoys such status. If the sole provider approach is, therefore, to be continued because of the thinness of the market, it is clearly important that safeguards are implemented. Competitively-tendered clear public service agreements with a range of safeguarding clauses have been adopted elsewhere in Europe and are clearly the most appropriate contract form for the Bailiwick.

PSAs will help to protect year-round schedules and help to create certainty in service expectations and the costs of maintaining that service. They will also give operators the certainty needed in order to increase investment in their routes and to grow passenger numbers.

The agreements should set clear standards, but allow the operators to be flexible and dynamic within those standards. If the agreements are too prescriptive, then Aurigny or other operators would become, in effect, contractors to the State. That would be counter-productive to the overall objectives of growth and improved service.

It should be the decision for the Committee for Economic Development how long the fixed term for each PSA runs for.

The PSAs should be open to transparent tenders consistent with Public Service Obligation routes in the European Union. This means that the criteria should be published, tenders invited from multiple operators, a selection panel convened to review responses, and economic incentives included in the contract to ensure good performance.

Each route should be reviewed by the Committee for Economic Development as part of its strategic review of air links, to benchmark their importance in supporting the economy. The Committee for Economic Development should also ensure that each route’s PSA supports economic enablement.

If and where competition is in the future introduced on non-essential routes, Aurigny and its board should decide whether to tender for these routes on a case-by-case basis.

Additional financial support could, of course, include reducing the prices of airport landing charges (prices based for example on marginal rather than average costs) and support for marketing, as is the case with the new Cardiff route operated by Blue Islands.

The Committee for Economic Development and STSB should be directed to assess the current economic value of Aurigny and air services through the visitors they bring in and via the taxes and charges that airlines pays. To this should be added an understanding of intangible social benefits. The Committee for Economic Development can then designate the importance of each route.
The panel notes that the Policy & Resources Committee, at the request of the STSB, has already proposed the development of a PSA for the Guernsey-Alderney and Alderney-Southampton routes. Work is ongoing, although a number of factors will input into this, including the decision taken on the rehabilitation of Alderney’s runway.

5. Operational and reliability improvements

Guernsey Airport and Alderney Airports are almost unique in the British Isles in that they are owned by government. The airports are under the supervision of the STSB and are expensive to operate. Government can therefore view the charges it makes to its customers as landing charges as economic enablers and reduce them when appropriate.

STSB should be invited to carry out an in-depth analysis of all the financing and other costs in order to reduce the landing fees charged to all airport users that contribute towards the economic prosperity of the Bailiwick.

STSB should also consider operational improvements that might enhance the experience of the travelling public and consider, amongst other things, whether:

- The installation of improved landing systems will improve safety levels during reduced visibility conditions - certainty and predictability of flights are paramount to the travelling public
- The airports should remain open for longer on certain days and particularly at peak holiday times
- Flights might be spread more evenly across the day
- The airport should take charge, in-house, of flight arrival and departure information
- At Guernsey Airport the payment for parking could be made easier with modern technology
- At Guernsey Airport a business lounge could be introduced air side

In the course of the panel’s work, a number of potential improvements were highlighted by individuals, representative groups and business bodies. These are included in appendix 1, and include actively exploring inter-lining and code-sharing agreements. The panel believes that STSB should write to Aurigny and ask them to consider the benefits and costs of each of these ideas.

6. Simpler pricing

The panel also strongly believes that Aurigny should move to a different pricing structure. Aurigny’s current policy objective, although unwritten, appears to be to maximise revenue regardless of spare capacity.

The current policy objective has also led to prices such as single tickets to London Gatwick of £200 or more for inward and outward journeys, which has been widely criticised as expensive for business or non-business travellers. It is clear that customers compare Aurigny to other operators such as EasyJet or Ryanair which have completely different business models, and which offer much cheaper tickets on short haul flights. While this is a false comparison, it is one that Aurigny needs to counter if it is to win back a strong reputation and positive brand, and moreover increased passenger volumes, especially of tourists with smaller travel and holiday budgets.
The view of the panel was that a wholesale reduction of fare prices would, short-term, have only a marginal benefit. It was deemed that the business market is ‘captive’ and demand largely inelastic to price. Long-term, the situation may, however, be different. There is a clear danger that businesses may seek other places to base their operations and that the price of travel will be factor in their decision-making. It was also considered that the potential for leisure travellers depended on the type of tourism that Guernsey wished to attract. As such, the reviewers believe that Aurigny should be set a mandate to work closer with the tourism and hospitality sectors in the Bailiwick in order to ensure lined up strategies.

If Guernsey wishes to attract mainly high spenders, high travel costs will be less of an impediment than if it wishes to attract a broader spectrum of visitors. The panel’s view was, consequently, that pricing was a matter that required wider consideration by the Committee for Economic Development – decisions made only on the likely impact on Aurigny were not in the Bailiwick’s wider interests.

Alderney’s representative on the panel noted that the position in Alderney is, however, different. He said that research undertaken by the States of Alderney had shown that a reduction in fares would be likely to increase travel. He added that the States of Alderney’s view was that a reduction in seasonal sea transport fares over the summer in 2016 resulted in a substantial increase in traffic.

Having said this, the panel believes that a flat fare system will not be a good business model for Aurigny. Aurigny needs to be able to differentiate between business and leisure customers and to target the services preferred by business customers with higher fares. The wider benefits of dynamic pricing, which frequently penalises everyone who chooses to buy a last-minute ticket are not, however, likely to be in the wider economic interests of the Bailiwick. There should always be cheap fares available at short notice – though not at the time of day preferred by business passengers.

What is clear is that customers would welcome different pricing, and that the board of Aurigny is prepared to try out a number of different approaches. The reviewers recommend that a simpler approach would benefit Aurigny and customers, and would support the strategic objective of increasing passenger numbers and therefore Bailiwick visitors.

The reviewers also believe that an effective flexible pricing policy for the Guernsey-Gatwick service could incorporate a maximum price. The panel had considered recommending a figure in the range of £120-150 (before APD) for a single journey, but would prefer to give Aurigny and the shareholder the flexibility to consider what would be the most viable. Tickets sold at this maximum price would be treated as fully flexible and there would be no rebooking charges. The current frequently applied £42 rebooking charge is seen by many customers as particularly iniquitous.

The tourism and hospitality sectors strongly believed that simpler pricing would benefit tourism. They also suggested, and the panel agrees, that if hotel and visitor attraction bookings were made available through the Aurigny website, this would further support the sector.

In summary, the panel concurs with the frequently articulated stakeholder position that, in order to become an effective economic enabler, Aurigny should strive to maximise seat sales, and that prices should be reduced when necessary in order to stimulate demand. While this might include a mechanism for ensuring ‘emergency availability’ for last minutes business, health or individual travellers, this should not result in maximum pricing on all last-minute bookings.
7. Alderney

The reviewers acknowledge the dissatisfaction in Alderney with Aurigny’s overall service, and believe there is much justification in that view through the culmination of a number of factors over a prolonged period of time.

Alderney’s representative on the review panel has clearly argued that both of Alderney’s air links are essential – to Guernsey for business, tourism and healthcare, and to Southampton for business and tourism. It is clearly very important that these links are serviced in a way that provides confidence in Alderney. The reviewers therefore believe that a PSA should be concluded between the States of Guernsey and the States of Alderney as soon as is possible, and that this should then be the basis of a tender to commercial operators.

Attracting candidate operators may not, however, be easy. Aurigny has expressed the view that it is likely that the involvement of Aurigny in a PSA tender (as a service provider) would mitigate against some commercial operators’ participation. As the States of Guernsey-owned airline Aurigny would be perceived to have a major advantage. Given the current lack of confidence in Aurigny, and the fact that Aurigny’s management has reported that the Alderney air links have been the cause of significant losses each year, the reviewers’ conclusion is that Aurigny should not necessarily tender for the Alderney air links, and that it might, instead, become the operator of last-resort – that is to say, if the contracted operator failed, Aurigny would be able to take over the service. With this in mind, the review of the fleet should only be undertaken once there is a clear understanding of the agreements of the PSA and outcome agreed and formally in place for the Guernsey-Alderney route.

Clearly a fresh approach would be of benefit to Alderney. It is the overwhelming preference of Alderney stakeholders. Many in Alderney believe that with the right commercial operator and with the right financial incentives, the routes could make a profit.

The reviewers’ view is that the value of the contract should be pegged to meeting the PSA targets. Anything beyond this target should be a matter for discussion between the operator and the States of Alderney, with both parties agreeing how those costs be met.

In the meantime the reviewers believe Aurigny should seek to improve customer service to support Alderney’s tourism and other business sectors. The panel hopes that the reported problems with passenger luggage will disappear once the second new Dornier is brought into service.

Wider issues with medevacs and freight do, however, need addressing. The panel hopes that Aurigny will continue to work with others in the transport and health sectors to ensure practical solutions. These requirements should be taken into account during the review of Aurigny’s fleet. Aurigny’s present approach which frequently views its service in isolation of the wider needs of the Alderney community needs to change. The economic and social needs of the island need to be viewed in a holistic manner and Aurigny needs to play its proper part.

The reviewers are confident that the current board has learned necessary lessons from the purchase of the older Dorniers. They note that the transition to the Dorniers could have been handled much more effectively.
8. Jersey

A number of stakeholders advocated that Aurigny should resume services to Jersey. The panel understands that if Aurigny as currently managed were to be asked to operate the Guernsey-Jersey route that the frequency of services and the price per seat would be roughly the same as is currently obtained from the present Blue Islands service provider. To replace one airline with another would achieve little for the travelling public.

The reviewers welcomed the fact that the Committee for Economic Development and Blue Islands are holding regular discussions to assess how the existing Jersey-Guernsey air links can be further improved. The reviewers believe that this route is a particularly important economic enabler.

The reviewers also recommend that the interests of Guernsey-Jersey travellers such as sports clubs and tourists seeking low-priced travel opportunities, might be better served through a more frequent and flexible sea link, and support the Committee for Economic Development in the work they are doing in that respect.

9. Guernsey-London City service

Aurigny began operating the Guernsey-London City service at the request of the island’s finance sector in 2014. Passenger numbers and demand have not matched the estimates put forward at that time, and Aurigny now services this route at a significant loss. Some respondents to the review believed that a different operator with different aircraft, a different timetable and potentially the ability to interline might generate more demand for this route.

Given the overall recommendations, the panel’s recommendation to the Committee for Economic Development in relation to this route is:

- Tender the route through a competitive and transparent process to an operator whose business model will make this route more likely to be serviced at an operational surplus
- Provide a fixed term contract to the chosen operator, and if appropriate provide investment to support the route through a Public Service Agreement

It is a decision for Aurigny’s board and management as to whether or not they tender to operate a future public service agreement on the London City route. The reviewers note, however, that there is potential interest from commercial operators and would welcome a competitive tendering process for the route.

The reviewers note that an alternative operator servicing the route might impact passenger numbers on the Gatwick route. The reviewers believe that competition of this sort should be seen as healthy in order to aid economic enablement, rather than as an impediment to Aurigny’s operations.
10. Interlining and franchising

A survey undertaken by the Institute of Directors in autumn 2016 strongly indicated that as part of its economic enablement role Aurigny should look into increasing ease of access to connecting flights. However, the panel note that the survey gave no indication as to preferred ultimate destination of the inter-lined flight.

It is clear that there is a significant appetite for the potential benefits of Aurigny having interlining agreements in place – both business and non-business customers. The reviewers support the objective given to Aurigny to actively explore the potential for interlining agreements being out in place.

The panel notes the Aurigny management's view that this might potentially be increase the risk for Aurigny. In particular they refer to the fact that weather issues in Guernsey may cause onward flight issues for customers, which in turn could create a significant potential financial liability for Aurigny.

The potential benefits of interlining are:

- **Consumer benefits** (ability to buy a through ticket, and check bags through to final destination)
- **Improved international business accessibility to Guernsey** (put simply: a PA, a travel agent, or a firm’s corporate travel department can easily book a through ticket from New York to Guernsey, Hong Kong to Guernsey, or Zurich to Guernsey – just as they already can to and from Jersey)
- **Passengers connecting through UK airports no longer have to pay Airport Passenger Duty.** This requires Aurigny to obtain IOSA Certification, which like any standards compliance measure carries a one off cost and then ongoing/recurring costs
- **Questions remain over the suitability of Aurigny’s existing booking system (TIK Aero), but in any event franchising or partnership require the necessary skillset and resource to negotiate and implement interlining or codesharing with another carrier (or a group of carriers within an alliance)**

Dependencies of interlining are that costs will accrue to Aurigny, but benefits will accrue not only to Aurigny but also to residents, visitors, and the Guernsey business community (especially those firms operating across numerous jurisdictions, and who need to transport clients, customers and employees to/from the island on a regular basis). It would therefore be appropriate for the shareholder to reflect on this, and give adequate weighting to the benefits versus costs. Interlining and codeshare (combined with the wider marketing reach of a stronger brand) would undoubtedly raise Guernsey’s profile and improve access. The ability to stimulate and attract new business is always hard to quantify, but nevertheless should not be underestimated.

The reviewers recommend that Aurigny explores the potential benefits and costs of interlining agreements in certain priority regions for business and non-business customers, and also what type of mitigation could be taken against the risks. For example, as few airlines travel globally Aurigny would need to decide which locations are best served by an inter-lining agreement when assessing potential partners.

**Franchising** has been explored by Aurigny, but the management of Aurigny has reported that a franchise agreement with a small carrier such as Aurigny is not economical to larger carriers. The present franchising and partnership options available to Aurigny are extremely limited, not just because of the company’s size but also because of the way the company is structured.
Aurigny’s own submission document presented to the panel addresses the perceived pros and cons of interlining and codesharing, but without any consideration given as to whether the airline actually possesses the means and expertise to enter into such agreements.

- While it has been posited by some respondents to the review that the absence of IATA (International Air Transport Association) certification is the main obstacle to franchising, Aurigny’s management has made clear that the views of larger carriers would be unchanged if that certification was put in place. However the lack of IATA certification is certainly a factor effecting Aurigny’s ability to enter into a meaningful joint venture partnership with other airlines. Other issues to be resolved in this context include: Aurigny’s reservations system and booking tool is not integrated and is limited in its capability to talk to mainline Computer Reservations Systems (IATA carriers, whether large or small, are predominantly linked to either the Amadeus, Sabre or Shares/PARS CRS platform)
- Aurigny will need to engage with the IATA Operational Safety Audit (IOSA) programme, which most major airlines insist on as a precondition for a partnership or joint venture (whether that be through interlining or codeshare).
- The IOSA programme involves an independent audit of a company’s safety culture, resilience of operations management (risk assessment), maintenance procedures and corporate governance. Audits are generally biannual, and help a regional airline’s management to identify any significant weaknesses or areas for improvement within the organisation. IOSA gives potential partner airlines reassurance that they can sell their brand with confidence, in the knowledge that their regional affiliate meets acceptable safety standards.

The logistics, regulatory and liability issues associated with interlining and codeshare were made clear to Aurigny’s board back in 2011, and at that time significant discussion took place regarding the pros and cons of IATA Membership. Since then however this seems to have fallen off the radar, and (except for a ticketing arrangement with Hahn Air for interlining through London City) little progress seems to have been made. There are still no connections being offered or sold onto other airlines services via the Aurigny website, or links enabling through ticketing to and from Guernsey on other airlines’ websites.

It may be tempting to take the view that joining a CRS/GDS, IATA membership, safety audits and all the extra associated costs may bring little immediate benefit to Aurigny. Nevertheless if Guernsey wishes to attract new business, strengthen its presence on the world stage, and enable its States owned carrier to negotiate agreements with other carriers (widening marketing reach and brand) these measures should be viewed as an essential and unavoidable necessity.

11. Airport runways

Businesses in Guernsey have asked for reliability, predictable pricing, excellent customer services and frequency of flights. Many businesses and representatives of businesses who approached the review argued that the economic enablement objective is best supported by aircraft that are comparatively small, flying as frequently as possible. Many of these submissions were unsure that runway length extension would bring significant benefits, and those that were less equivocal acknowledged that low cost carriers with larger aircraft would, undoubtedly, offer reduced frequencies.

The reviewers were unable to reach a conclusion on the case for extending the airport runway. The view of the panel was that the extension of the Guernsey Airport runway that has been proposed in some quarters should not proceed until a strong economic case can be made – and they supported a
full economic options analysis being undertaken as part of the States of Guernsey capital prioritisation process during 2017.

In order to strengthen reliability and rebuild confidence in the air links, the reviewers recommend that STSB should investigate as a matter of priority how the current runways can be supported with an approach lighting system to mitigate against the impact of fog on flight reliability.
12. Proposed revised shareholder objectives and key performance indicators

Note: revisions from the current version are highlighted as new text or struck through where they should be revised/removed

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<tr>
<th>Area</th>
<th>Shareholder Objective</th>
<th>Indicators</th>
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| **Operational**    | - Increase the number of passengers carried by the airline  
- Maintain and operate six pairs of slots at Gatwick Airport. On routes deemed as economically and/or socially essential, meet the provisions of a public service agreement and provide a case for States of Guernsey additional investment and support where required and appropriate  
- Maintain a capability to service Alderney should a commercial operator not be found through a competitive tender  
- Ensure 89% of departures leave within 15 minutes of scheduled departure time  
- Present a business case to develop/implement interline/codeshare capability to subject to the submission and acceptance of a satisfactory business case by the shareholder by Q3 2017  
- Improve management and financial information | - Total pax carried (monthly vs prior year)  
- Total load factor (monthly vs prior year)  
- Economic value of pax numbers  
- LGW load factors (percentage of flights per month operating at 100% and report by exception on flights operating beyond 95%)  
- System wide (including route by route) punctuality report (three month rolling average by aircraft type)  
- LGW cancellations report (3 month and 12 month rolling averages of operated flights vs planned schedule) |
| **Commercial & financial** | - Achieve a breakeven position for the Aurigny Group on a full profit and loss basis, excluding agreed exceptional one-off costs and losses incurred in operating lifeline services to and from Alderney agreed with the Shareholder  
- Move to a sustainable operating surplus year on year  
- Optimise the airline’s operating cost base, with no real-terms increase in controllable costs per available seat kilometre compared to 2015  
- Offer 63% of seats on LGW services at £69.50 or less (excluding APD) | - EBITDA, EBIT and P&L [Note: this measure has been removed due to the level of capitalisation and subsequent low levels of interest-bearing debts]  
- System wide (including route by route) passenger yields (monthly and year to date)  
- LGW passenger yields (monthly and year to date)  
- Costs per available seat kilometre (controllable and non-controllable)  
- System wide revenue per available seat kilometre  
- Cash vs budget  
- Monthly sales vs prior year |
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<th>Safety</th>
<th>Customer/island reputation</th>
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| • Apply an upper level for highest priced seats (before UK APD) on LGW services  
• Apply a simple pricing policy on all routes | • Total destinations served  
• Monthly revenue vs prior year  
• Seat sales by fare value  
• Ensure there are no level 1 CAA audit findings |
| Monthly revenue vs prior year  
Seat sales by fare value | Safety  
Maintain a licence/capability to operate  
Ensure there are no level 1 CAA audit findings |

A further reassessment of the shareholder objectives should be carried out once various proposals have been concluded and resolved. These proposals include:

- To rehabilitate/extend the airport runway in Alderney
- To extend the airport runway in Guernsey
- To establish a PSA for the Alderney service and which will have an impact, amongst other things, on the reduction in number of aircraft types required in the fleet
- To improve the brand’s visibility – and to consider whether one option might to incorporate the word ‘Guernsey’ into current livery, online presence, marketing materials for example
- To develop an air route strategy that will include a procedure for targeted route development to serve both outbound and inbound markets
- To carry out an unconstrained review of the Aurigny fleet (following the outcome of the PSAs),
- To undertake a review into how the runways can be supported with an approach lighting system to mitigate against the impact of fog on flight reliability

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13. Detailed recommendations

Based on the conclusions above, the panel recommends the following to the Policy & Resources Committee:

1. Aurigny to remain under government ownership for the foreseeable future.

2. Aurigny should prioritise economic growth and development, which with the right shareholder objectives (maximising passenger numbers) will support access to affordable transport for islanders and visitors.

3. The PSAs need to be balanced out with competition on other routes where the market can sustain it and where there is capacity that will grow the passenger numbers on the route. The air traffic licensing regime should be modified to reflect this new strategy.

4. Aurigny should focus on maximising passenger numbers in order to achieve that.

5. To support 4. Aurigny should introduce simpler pricing structures.

6. The States Trading Supervisory Board should consider how best to provide a mix of support for Aurigny and/or independent operators on routes where it is agreed that operators cannot meet some of the PSA provisions.

7. The Committee for Economic Development should work with the STSB on the economic value of all routes in developing the public service agreement approach.

8. The States Trading Supervisory should work with the board and executive of Aurigny to establish how the company can move to a sustainable financial position of an operating surplus year on year through a combination of:
   - Effective public service agreements introducing targeted investment from the States of Guernsey
   - Operational and reliability improvements
   - Revised shareholder objectives

9. The revised shareholder objectives in this report should be adopted, and then reviewed after the following proposals/decisions have been concluded and resolved:
   - Rehabilitation/extension the airport runways in Alderney and Guernsey
   - Establishment and tendering of a public service agreement for the Alderney service which will have an impact, amongst other things, on the reduction in number of aircraft types required in the fleet
   - Development an air route strategy that will include a procedure for targeted route development to serve both outbound and inbound markets
   - Review of air licensing framework

10. The shareholder should consider the following service improvements for the airport:
    - Improved landing systems during limited visibility should be considered as certainty and predictability of timetable are paramount to the travelling public
The airport should remain open for longer on certain days and particularly at peak holiday times
- Flights could be spread more evenly across the day
- The airport could take charge, in-house, of flight arrival and departure information
- The payment for parking could be made easier with modern technology at Guernsey Airport
- A business lounge could be introduced at Guernsey Airport

11. The Alderney-Guernsey and Alderney-Southampton routes should be tendered to potential independent operators as soon as the PSA is concluded. Aurigny should not be compelled to retender to provide this service, but should be prepared to be a provider of last resort.

12. The Committee for Economic Development should consider whether to put a PSA in place on the Guernsey-Jersey route.

13. A PSA should be put in place on the Guernsey-London City route by the Committee for Economic Development, and opened up to multiple operators to tender through a clear and transparent process.

14. STSB should write to Aurigny asking them to examine the costs and benefits of a number of potential service improvements including inter-lining and code-sharing, fast track transit at London Gatwick and other destinations, and improvements to the website to allow through-booking of island accommodation and attractions.

15. Aurigny to conduct a detailed exploration of the potential for inter-lining and code sharing within six months of this review in conjunction with the shareholder and the Committee for Economic Development.

16. STSB should set Aurigny a mandate of collecting and providing relevant, accurate and up to date management information on a yearly basis. Furthermore, Aurigny should endeavour to make sure such information is available within a reasonable amount of time if requested by the States of Guernsey.

17. An unconstrained review of Aurigny’s fleet should be undertaken, including assessment of landing technology to manage reduced visibility, and to consider the option of leasing the fleet.

14. Proposed next steps

If the Policy & Resources accepts these recommendations, and they are endorsed by the States of Deliberation, the following next steps are proposed:

- STSB after consultation with Aurigny to respond to these recommendations within three months of this review being published.
- A review of the air traffic licencing regime should be carried out and established once recommendations are adopted.
- The Committee for Economic Development to undertake an economic value review to determine the direct and indirect economic value of all routes where public service
agreements are proposed within six months of this review. This should follow on from the outcomes of the Committee for Economic Development’s review of strategic air links.

- Public service agreements to be agreed by the Committee for Economic Development and STSB for each route agreed within three months of the completion of the economic value review.
- The Committee for Economic Development to decide which routes to prioritise piloting public service agreement arrangements on. The reviewers’ recommendations are Guernsey-Alderney due to the perceived need for an improved service on the route; and Guernsey-London City as it is a route which is perceived to be under-performing and which might benefit from a more market-led approach.
- The Committee for Economic Development and the Transport Licensing Authority to begin the tendering process for the routes that will be operated under public service agreements within twelve months, prioritising those routes which can be tendered now and also setting out which can be tendered in the future.
- STSB to respond to the detailed recommendations in Appendix 1, within six months of the review being published.
- STSB to begin the review of Aurigny’s fleet, once the details of the PSAs have been agreed and arrangement has been put in place for the Guernsey-Alderney route.
Appendix 1 – Potential service improvements

A letter should be sent by STSB to Aurigny asking the board and management to prepare a series of fully-costed proposals to enhance the social, financial and customer care performance of the airline to cover the following:

- It is clear that the marketing ‘bandwidth’ and brand visibility for Aurigny are not significantly robust. What measures are the directors taking to improve these matters and can the States of Guernsey assist the airline in any way? Is additional shareholder investment required? Greater coordination between Visit Guernsey, Visit Alderney, Locate Guernsey, Alderney eGaming Limited and Guernsey Finance is required for marketing and visibility and an External Marketing Group should be formed comprising representatives of the States bodies and Aurigny.
- Actively explore membership of the Gatwick Connect Protected Connection Service. This is where the tickets are bought through Gatwick Connects, and for an additional charge the connection is protected, with costs related to a missed connection protected by Gatwick, rather than the airline. This apparently includes replacement flight and hotel and meal vouchers.
- Introduce a new service at the gate for inwards flights. Travellers should be given the chance to reserve taxis before boarding the plane.
- The website and booking system should be enhanced such it can be more customer friendly and offer better participation in the Global Distribution System which is used by travel management companies and travel agents when booking flights. Is additional shareholder investment required? The booking process should include a ‘reason for travel’ question in order to aid with the collection of management information.
- What changes need to be made to the Aurigny website improvements in order to enable through-booking of accommodation and attractions in Guernsey and Alderney?
- Currently Aurigny is not a member of IATA nor do they possess IOSA certification. What benefits do the Directors believe would be accrued to the airline should these be achieved? Is additional shareholder investment required?
- Consult with GIBA for a clear response on which single airline Aurigny should focus on in respect of inter-lining or code-sharing opportunities
- Would the Directors provide a report on the operational savings that could be achieved if in future all hold baggage was to be paid by customers?
- The operational costs of a mixed fleet from a Guernsey base are substantial. What measures can the Directors suggest to reduce those costs without reducing operational performance? Is additional shareholder investment required?
- Complaints are regularly received from customers in respect of cabin luggage. What measures can the Directors suggest that would improve customer experience? Is additional shareholder investment required?
- Aurigny has a deserved reputation for good customer service and for friendliness. It enjoys a high local visibility but complaints are regularly received from customers in respect of reliability of service. What measures can the Directors suggest that would improve reliability of service and particularly in respect of limited visibility conditions? Is additional shareholder investment required?
- Using some of the factors above and also further improvements in customer service to introduce a ‘business class service’. This would link into the business lounge idea for Guernsey Airport, and might also include a separate check in, fast track security and special offers on drinks of food airside. This might be one way to further differentiate Aurigny’s product and further target differences in price elasticities
The terms of reference pose the question – *what kind of service should Aurigny be offering in five and 10 years’ time?* Based on the views of individuals through their organisations, the following are achievable aspirations for Aurigny, notwithstanding any decisions on runway extension or new routes:

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<tr>
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<th>Aurigny 2022</th>
<th>Aurigny 2027</th>
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<tbody>
<tr>
<td>Guernsey</td>
<td>Public service agreements operating</td>
<td>Public service agreements renewed</td>
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<td>Greater frequency on lifeline routes compared to 2017</td>
<td>Greater frequency on lifeline routes compared to 2022</td>
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<td></td>
<td>Increased passenger numbers on routes operated</td>
<td>Continued increase in passenger numbers through greater frequency of lifeline links</td>
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<td>Primary focus on lifeline links</td>
<td>Continued focus on lifeline links and economic enabler routes, including potentially operating newer economic enabler routes</td>
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<td>Operating economic enabler routes with investment from government</td>
<td>Simpler pricing remaining in place, and website a valuable portal for Guernsey’s tourism and hospitality industry</td>
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<td>Simpler pricing in place, and website offers for inward visitors for booking accommodation and attractions</td>
<td>Inter-lining or codeshare agreement in place with an airline designated as a priority by Guernsey’s business sector</td>
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<td>Less diverse/smaller fleet than 2017</td>
<td>More modern fleet</td>
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<td>2-3 years of consecutive operating surplus</td>
<td>Year on year operating surplus</td>
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<td>Competing with new air routes developed by the Committee for Economic Development to support economic growth</td>
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<td>Conclusion of progress in relation to on GDS, IATA and IOSA</td>
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<td>Alderney</td>
<td>Public service agreements in place for Guernsey and Southampton, potentially serviced by an independent operator</td>
<td>Public service agreement in place serviced by an independent operator</td>
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<td>Aurigny capability to provide ‘plan B’ or additional capacity of required and agreed</td>
<td>New routes developed with independent operators; Aurigny a potential bidder</td>
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<td>Aurigny capability to provide ‘plan B’ or additional capacity of required and agreed</td>
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