

Isle of Man Air Services Review



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- B Peer markets**
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- D COVID-19 recovery**
- E Public Service Obligation (PSO) Routes within an EU Context**
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Executive Summary

Overview

Steer has been commissioned to provide the Isle of Man Government with support to develop the Island's long term strategy for air services. This includes identifying the key route markets, a capacity and frequency of service that would meet the needs of both the leisure and business markets, and any financial incentivisation or policy intervention that may be required to deliver the optimal route network that would best meet the needs of the Island's economy.

Current Policy

The current "Open Skies" policy was introduced on routes to/from the Isle of Man (IOM) in 1993 in parallel to the EU liberalisation rules on civil aviation, which allowed any airline within the EU to operate scheduled and charter services to any point within the EU without the need for a route licence. The purpose of Open Skies was principally to improve competition and thereby to lower fares and to improve services, with a resultant boom in capacity, new routes, choice, and traffic growth across Europe over the last 25 years.

However, full market freedoms may also be detrimental to the overall connectivity of the Isle of Man. For example:

- The primary aim of privately owned airlines is to generate profit for shareholders, rather than to support island connectivity. This can lead to non-regular scheduling year-round and highly variable fares;
- Larger aircraft favoured by low-cost carriers may not permit the same levels of frequencies preferred by business travellers without creating over-capacity; and
- There is no mandated requirement to provide a regular service, which permits airlines to redistribute aircraft capacity to other more profitable routes when desired.

Market Performance to date

Passenger traffic levels to and from the Island rose steadily between 2011 and 2019 by an average of +2.5% per year, rising from 702,000 to 855,000. However, during this period, the Open Skies policy of allowing the market to freely operate led to a decline in the number of different destinations, and equally as important, the frequency of services on some of the most important destinations, resulting in a route network that has potentially become sub-optimal in several ways, such as:

- Lower frequency on some services, not providing business customers with the ability to conduct a day return journey;
- Reduced capacity that does not satisfy the demand of the overall passenger market to some destinations; and
- Limited opportunities to connect to global air networks via other large airports.

COVID-19 Recovery

The route traffic analysis is primarily based on performance to 2019, and notwithstanding the impact of some potential structural changes in traffic demand affecting the rate of traffic recovery post COVID-19 (e.g. a potentially slower recovery in business traffic due to increased working from home), the assumption is that traffic volumes will recover to 2019 levels eventually.

An outlook on the prospective recovery profile of traffic to/from the Isle of Man has been constructed for the purpose of reviewing policy and service options based on a review of the following:

- Recovery of the Isle of Man market after the 2008 financial crisis;
- The October 2021 Eurocontrol forecast for the UK; and
- OAG capacity scheduled to the Isle of Man for the remainder of 2021 and early 2022.

Combining data and trends from these sources it has been assumed that traffic will recover to:

- 81% of 2019 levels in 2022;
- 95% of 2019 levels in 2023;
- 99% of 2019 levels in 2024; and
- 100% of 2019 levels in 2025.

Key destination markets

The Isle of Man Department for Enterprise conducted a survey to collate the views of Isle of Man residents on service requirements. Four destinations were identified as being the most important for the business and leisure markets – Liverpool, Manchester, Dublin, and London. Within the London market, Gatwick, Heathrow and London City were cited by the respondents as the most important destinations.

Options for Supporting Network Development

A combination of regulatory and commercial levers provides a spectrum of approaches by which services can be either retained, expanded, or improved. These have been outlined in the table below, which also presents the compatibility of each of the option combinations.

Table ES 1: Available policy options

Regulatory levers → ↓ Financial levers	Open Skies	Quasi-Open Skies	Route Licencing
Commercial incentivisation	✓	✓	✓
Public Service Obligation	✓	(✓)	(✓)
Removal of Airport Passenger duty	✓	✓	✓
Establishment of a Manx airline	✓	(✓)	✓

Source: Steer Legend: ✓ Compatible, (✓) Partially compatible, - Not compatible

Regulatory levers

The Isle of Man has the ability to define the level to which its **market is regulated**.

- Under the current **Open Skies** agreement any UK registered carrier is permitted to fly services to/from the Isle of Man and is not subject to route, frequency, or capacity constraints. Any carrier can add capacity to the market, even if demand is not sufficient to warrant it, creating a risk of over-capacity and the loss of an incumbent operator.
- The application of **Quasi-Open Skies** would involve designating certain routes as ‘regulated’ whilst maintaining the remainder of the market as Open Skies. Under this option licences would be required by carriers to operate on the regulated routes, possibly with frequency and/or capacity restrictions being enforced. These licences would be issued by the Isle of Man.

- **Full route licencing** extends this practice to all routes from the Isle of Man; all carriers flying all routes would require a licence and might have to operate within frequency and capacity restrictions. The application of route licencing to all or some routes is a means to prevent overcapacity and predatory behaviour on routes.

Financial levers

The regulatory levers can be combined with the following financial levers to promote desired services:

- *Reduced airport charges and/or incentives for new routes or services* provide two ways in which **Commercial Incentivisation** on desired routes can be provided. The application of commercial incentivisation retains the underlying principle of Open Skies competition by not restricting an airline's access to any specific route¹.
- Designation of routes as **Public Service Obligation (PSO)** would permit the IOM Government to provide an operating subsidy to a carrier to operate specified routes with defined frequency and capacity. PSO routes can be applied on services to a 'peripheral or development region' and therefore it may be possible that routes to the Isle of Man would qualify.
- The **withdrawal/reduction of Air Passenger Duty (APD)** from the IOM was not determined to be an effective means to ensure services on critical routes.
- The **Establishment of a Manx airline** based on the IOM and funded by the Government, may appear to address the key issue of serving key critical destinations with an optimum schedule in terms of frequency and timings, but will be by far the most expensive option for consideration. Additionally, it is likely that the new airline would face difficulty in gaining access to London airports at optimum times, given the fact that runway and terminal capacity constraints (slots) at the key London airports (and other key European hub airports) may not enable the delivery of an optimum "business" day return schedule. Any new aircraft fleet would likely be assigned to a 'non-optimised' network schedule putting further cost pressures on the airline's financial viability.

Peer Markets

Given that a financial support package is referenced above as one of the potential approaches to supporting further airport network development, it is consistent with the approaches taken by the majority of UK peer airports as noted in Appendix B.

Apart from Jersey, all the other peer airports referenced in Appendix B (Guernsey, Newquay, Derry/Londonderry, Dundee, and Teesside) offer some form of financial/regulatory subvention to those airlines operating direct services to London. Whilst the majority of these peer airports provided subvention due to a complete lack of direct services to London from their respective airports, such an approach may be considered appropriate for the IOM to consider in order to secure a sustainable and consistent flight schedule to key London airports that provides enhanced regional and global connectivity for the business and leisure market sectors.

Potential Approach

For the four core markets, our assessment can be summarised as follows:

¹ However it would be compatible with the other forms of regulation stated.

Figure ES 1 Summary of potential options for route development on core routes

Destination Market	Required change to network offering	Additional financial support required	Regulatory regime applied	Net Cost (£m) ²
Liverpool	None.	None.	Open Skies. Route operates sustainably with two carriers (provided PTC contract is maintained). Should the status-quo change and there is a risk of external predatory behaviour then route licences for incumbent airlines should be considered.	Redacted
Manchester	Choice between high frequency regional service, enhancing connectivity or low-frequency option with mainline aircraft. Market unlikely to sustain both.	Only through airport charges. Possible opportunity to extend the scope of the PTC contract to include services to MAN for operator to provide multiple daily services	Open Skies, but if financial incentives/disincentives are not enough to influence optimal network, then consider the application of a route licence ³ .	Redacted
London	Additional capacity and frequency of services required. Ideally additional airport destinations (LCY/LHR) required.	Yes – additional financial support likely.	Application of route licencing for LGW, LCY and LHR, providing protection for incumbent and/or new carrier to operate without fear of additional competition on the route.	Redacted
Dublin	New service required. Likely awaiting Emerald Air (Aer Lingus) to grow after its accelerated start-up.	Only through application of lower airport charges to secure the reintroduction of a new service, combined with start up support	Open Skies. Route likely to return when market demand returns, likely operated by just one carrier.	Redacted

Source: Steer analysis

² These are the net costs associated with sustaining a service that will break-even and associated costs can be covered though commercial incentivisation or with a PSO agreement. Liverpool (with PTC), Manchester and Dublin have historically operated profitably without direct financial support.

³ A route licence should only be issued when the preferred carrier is operating the route solely. Currently this is not possible as two carriers are operating on the route.

Glossary

Name	Meaning
ACMI	A type of aircraft lease that covers the cost of the aircraft, crew, maintenance, and insurance
AOC	Air Operators Certificate
APD	Air Passenger Duty
ASK	Available Seat Kilometre
ATR72	Turboprop aircraft, typically up to 78 seats
A319/A320	Airbus A319/320 aircraft
CAA	The UK Civil Aviation Authority
CAGR	Compound Annual Growth Rate
COVID-19	Coronavirus Disease 2019
ERJ	Embraer Regional Jet
Eurocontrol	The European Organisation for the Safety of Air Navigation
FY	Financial Year – April to March
GCI	Guernsey Airport
GDP	Gross Domestic Product
IATA	International Air Transport Association
IOM	Isle of Man Airport
JER	Jersey Airport
KPI	Key Performance Indicator
LCY	London City Airport
LGW	London Gatwick Airport
LHR	London Heathrow Airport
LPL	Liverpool Airport
LTN	London Luton Airport
MAN	Manchester Airport
MIDT	Database that collects passenger numbers and fares booked through travel agencies
MTOW	Maximum Take Off Weight
OAG	Company that provides digital flight information, intelligence and analytics for airports and airlines, including flight schedules, passenger traffic and capacity
Open Skies	European Union agreement enabling any EU airline to operate services between two EU airports without the need for a route licence.
PSO	Public Service Obligation
PTC	Patient Transfer Contract
SOU	Southampton Airport
USD	United States Dollars
STN	London Stansted Airport

1 Introduction

Overview

- 1.1 Steer has been appointed by the Isle of Man Government to provide assistance with a strategic review of air traffic services to and from the Isle of Man.
- 1.2 This is our Final Report.
- 1.3 The purpose of the review was to assist the Isle of Man Government in developing a long term strategy for air services to the Island, considering:
 - current policy;
 - other policy and economic levers;
 - existing and historical air route performance;
 - the needs of the business and leisure markets to and from the Isle of Man; and
 - economic and social benefits.

Background

- 1.4 Passenger traffic to and from Isle of Man Airport grew steadily between 2011 and 2019 by an average of +2.5% per year, rising from 702,000 to 855,000.
- 1.5 However, during this period, the number of different destinations, and equally as important, the frequency of services on some of the most important destinations, declined, resulting in a route network that is potentially sub-optimal in several ways, such as:
 - Lower frequency on some services, not providing business customers with the ability to conduct a day return journey;
 - Reduced capacity that does not satisfy the demand of the overall passenger market to some destinations; and
 - Limited opportunities to connect to other global networks via other large airports.
- 1.6 The current air market to and from the Isle of Man is governed by 'Open Skies' principles, namely that market forces generally dictate the capacity and frequency of air services to and from the Island, with no policy intervention from the IOM Government.
- 1.7 Open Skies has generally been considered to have been a successful policy for the development of aviation markets throughout Europe since 2003, with significant passenger growth, new frequencies and supporting the opening up of new routes. However, there is a concern that such a policy may not be the ideal approach for smaller markets - and in particular island communities where air links are vital - and that the reintroduction of some Government/policy intervention may be required to support an optimal air services network.

Approach taken

- 1.8 In order to provide a set of preferred options for the Government to consider as part of its future policy, the remainder of this report is structured as follows:

- Chapter 2 – A summary of air traffic performance over the last decade to and from the Isle of Man, set against the background of the current policy towards air traffic;
- Chapter 3 – A summary of the policy options that are available; and
- Chapter 4 – An assessment of the impact that each policy option may have, set against a desired set of route frequencies that meet the needs of both the business and leisure markets.

1.9 A set of Appendices has been provided. Included within these are additional detailed information covering the route performance analysis, the needs analysis (survey) of the business and leisure markets, and a comparison of traffic and policy performance against peer airports.

2 Current policy and performance

Current policy

The current "Open Skies" policy was introduced on routes to/from the Isle of Man in 1993 in parallel to the EU liberalisation rules on civil aviation, which allowed any airline within the EU to operate scheduled and charter services to any point within the EU without the need for a route licence. The purpose of Open Skies was principally to improve competition and thereby to lower fares and to improve services, with a resultant boom in capacity, new routes, choice, and traffic growth across Europe since then. However, full market freedoms may also be detrimental to the overall connectivity of the Isle of Man. For example:

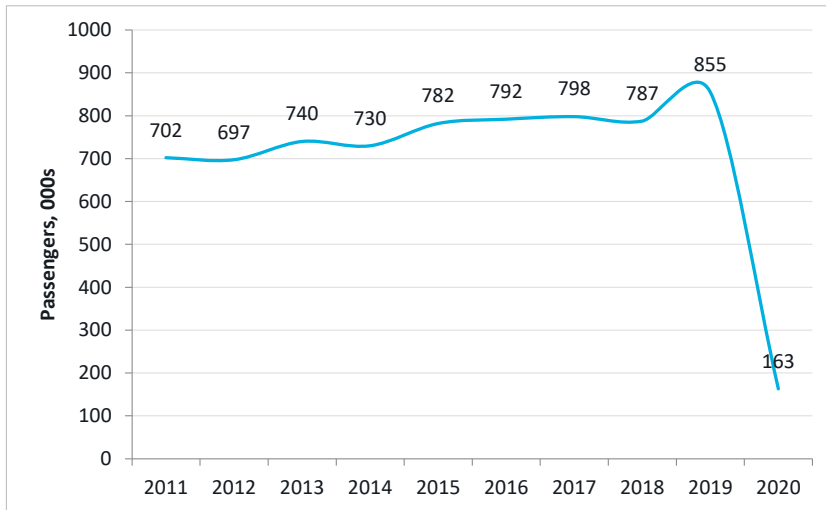
- 2.1 The following concepts have been investigated as part of our strategic review:
- The primary aim of privately owned airlines is to generate profit for shareholders, rather than to support island connectivity. This can lead to non-regular scheduling year-round and highly variable fares;
 - Larger aircraft favoured by low-cost carriers do not permit the same levels of frequencies preferred by business travellers without creating over-capacity; and
 - No mandated requirement to provide a regular service permits airlines to redistribute aircraft capacity to other more profitable routes when desired.
- 2.2 A review of historical traffic performance for the Isle of Man has been conducted together with detailed analysis on core routes identified. A review of service provisions and how they are provided in peer markets has then been conducted.

Traffic performance

Passengers

- 2.3 Passenger traffic to and from the Isle of Man has grown gradually over the last decade, from 702,000 in 2011 to 855,000 in 2019 (CAGR +2.5%). This is below the average growth in passenger numbers for the United Kingdom, which grew at an average rate of +4.1% per annum over the same period. However, it is higher than passenger growth at both Jersey and Guernsey airports.

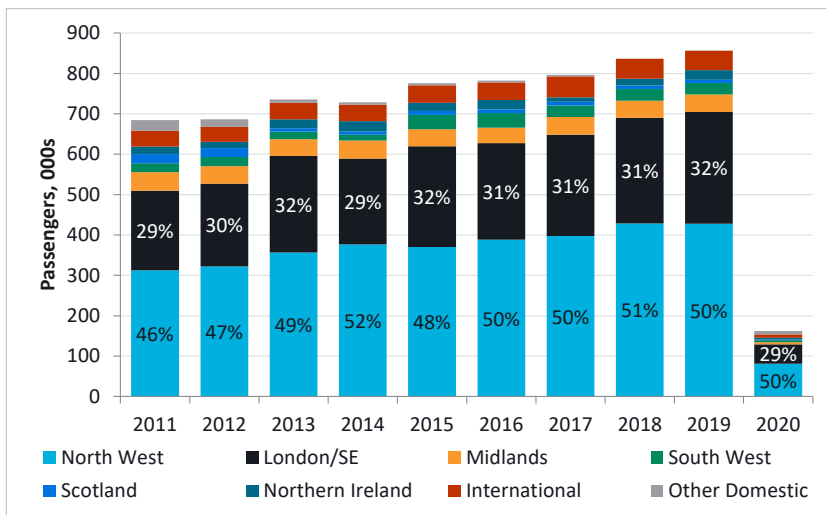
Figure 2.1: Isle of Man - total passengers, 2011-2020



Source: CAA, Steer analysis

2.4 The majority of passengers travel to destinations in the North West of England⁴ (50%) and to airports in London and the South East of England (32%). The proportion of passengers travelling directly to these regions from the Isle of Man increased from 75% of total passengers in 2011 to 85% in 2019. Conversely the proportion of passengers travelling to other destinations in the UK reduced from 19% to 9% in the same period, primarily driven by reductions in services on these routes by airlines Flybe and Manx2/Citywing⁵. The share of passengers travelling on international routes remained relatively consistent at around 6% per year. Around 85% of these passengers are travelling to Dublin.

Figure 2.2: Isle of Man - passengers by first destination



Source: CAA, Steer analysis

⁴ primarily Liverpool and Manchester

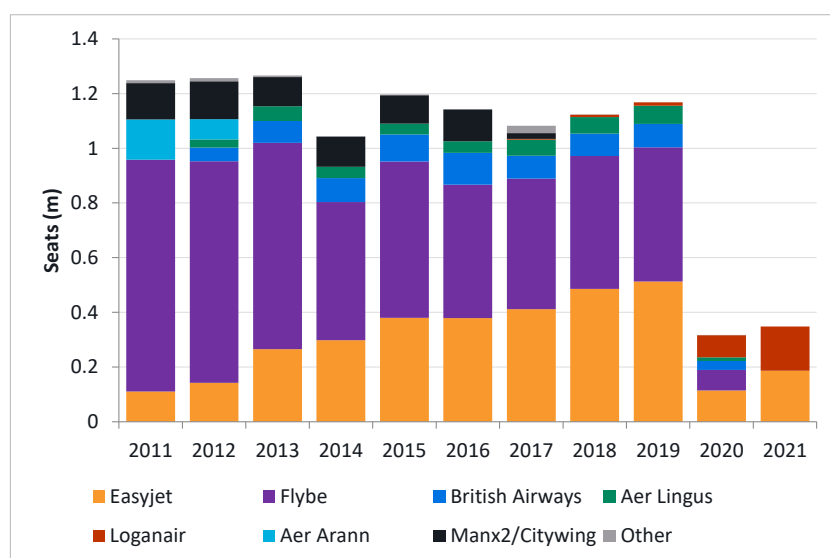
⁵ Manx2 was a commuter airline, which operated between 2006 and 2012. In 2012 its assets were sold to Citywing, which continued operations until 2017.

Airlines

2.5 Whilst passenger traffic volumes grew steadily over the last decade, the change in the mix of destinations and airlines over the same period has been considerably more volatile:

- In 2011, Flybe was the primary operator at the airport, operating 68% of capacity, whilst Aer Arran (12%) and Manx2 (11%) and easyJet (9%) made up the remainder. 16 scheduled destinations were served from the Isle of Man directly⁶ and the average aircraft size was 54 seats;
- By 2019, easyJet had increased its market share at the airport to 44% of capacity, whilst Flybe’s share of capacity reduced to 42%. Most of the remaining capacity was operated by IAG carrier BA Cityflyer (7%) and Aer Lingus (6%). 11 scheduled destinations were served from the Isle of Man directly and the average aircraft size was 91 seats (+70%).

Figure 2.3: Isle of Man - seat capacity by airline



Source: OAG; Steer analysis

2.6 Changes to capacity flown by each airline were influenced by the following market changes:

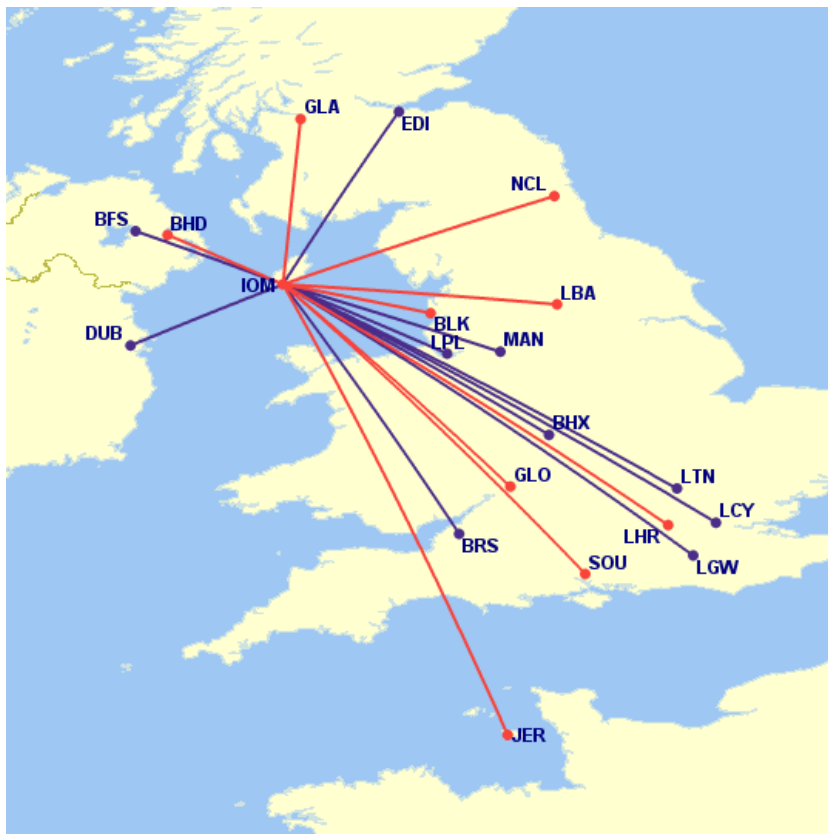
- **easyJet’s** entry to the Isle of Man - Liverpool market (2010) with 156 seat Airbus A319 aircraft and subsequent entry to the London Gatwick route (2012) and other UK connections. Flights are now operated with a mixture of A319 and 186 seats A320 aircraft;
- **Flybe** closing its operational base at the airport in March 2014, removing based aircraft and staff. This will have been partly influenced by the sale of its London Gatwick slots and the subsequent withdrawal of its (high-frequency) London-Isle of Man connection. These slots were purchased by easyJet, who consequently increased frequencies to the Isle of Man, but to approximately 50% of the level previously operated by Flybe;
- A change in strategy of **Aer Arran**, who previously operated routes to Dublin and London City. On rebranding to ‘Stobart Air’ franchise agreements were made with Aer Lingus Regional and Flybe, and flights were operated under these brands. A Stobart Air base operating flights for Flybe was opened in Summer 2016;

⁶ With more than 10,000 seats per year

- British Airways subsidiary **BA CityFlyer** taking over the London City route from Aer Arran. This route was operated until 2020;
- The closure of **Citywing** in 2017 after the airline they were wet-leasing aircraft from lost its UK operating licence. This resulted in the loss of many ‘regional’ routes from the Island, such as Blackpool, Leeds Bradford, and Newcastle. Citywing primarily operated 19-seat aircraft;
- Flybe briefly operating a route to **London Heathrow** in Summer 2019 using slots leased to them by (then parent carrier) Virgin Atlantic/Delta. This route was discontinued from the end of the Summer 2019 season; and
- Bankruptcy of Flybe in March 2020 and takeover of some routes by **Loganair** to provide island connectivity during the COVID-19 pandemic. (Government subsidy provided to assist with the viability of operation).

Destinations

Figure 2.4: Routes operated from the Isle of Man in 2011 and 2019



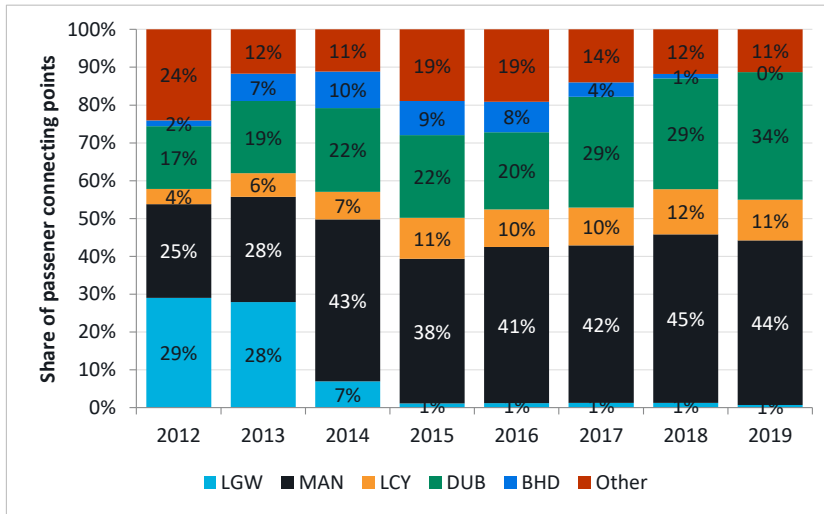
Source: CAA, GC Mapper, Steer analysis [Blue – Continued operation in 2011-2019, Red – Cancelled]

True origin/destination

2.7 According to OAG Traffic Analyser the share of passengers with onward connections has consistently accounted for approximately 11% of passengers departing from the Isle of Man. Figure 2.5 presents the main connecting points used for itineraries from the Isle of Man to reach their final destination. London Gatwick was the largest connecting point for passengers until Flybe withdrew from the route in 2014. Flybe maintained codeshares with many airlines at Gatwick, which easyJet did not. Manchester has been the largest connecting point since 2014 and accounts for 40-45% of connecting itineraries. The proportion of passengers

transferring through London City and Dublin has increased since 2014, while connections through other markets has reduced.

Figure 2.5: Isle of Man - Main connecting points

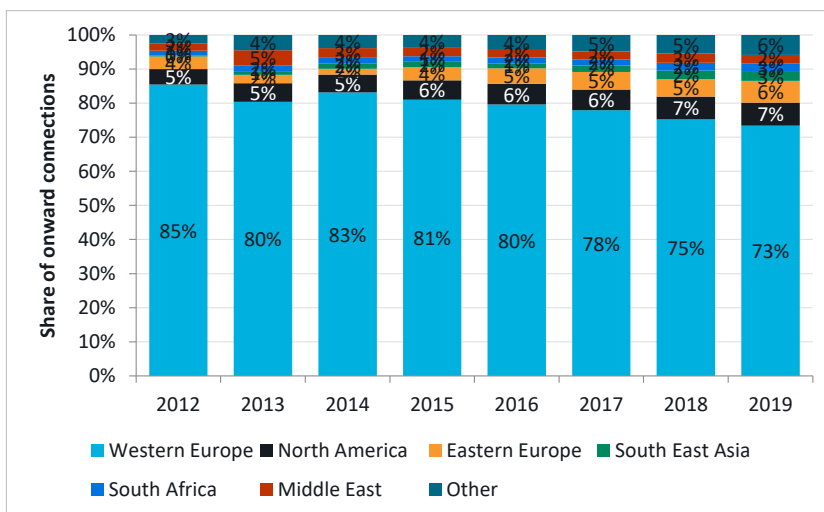


Source: OAG Analyser, Steer analysis

2.8 Manchester Airport provides a wide range of direct connections to destinations in Western Europe, North America, the Middle East, and South East Asia on network airlines as well as additional connections to Western and Eastern European destinations on low-cost carriers. The presence of large network carriers such as Emirates, Qatar, Etihad, Ethiopian, KLM, Air France and Lufthansa provides one-stop connections from Manchester to most global destinations. Dublin provides direct connectivity to North America and permits passengers to pre-clear US Customs in Dublin, saving time on arrival and providing swifter connections through US airports. Aer Lingus and Ryanair also operate a large European network from Dublin. Connections to European business centres and leisure destinations can also be achieved through London City Airport.

2.9 In 2019, the majority of passengers with onward connections travelled to destinations in Western Europe (73%), whilst Eastern Europe accounted for a further 6%. 7% of passengers travelled through to destinations in North America, as shown in Figure 2.6.

Figure 2.6: Final destinations for onward passengers



Source: OAG Analyser, Steer analysis

- 2.10 This data does not account for self-connecting passengers, who purchased two separate tickets to make their journey⁷ or those using ‘Worldwide by easyJet’, (for both of which data is unavailable). London Gatwick will still likely represent a valuable connecting point to passengers due to regular flights from the Isle of Man and due to the large European network operated from the airport. Long Haul connections are also available from London Gatwick, however to a lesser extent than from London Heathrow. easyJet flight schedules from the Isle of Man on most days prevent seamless connections due to a post-10pm arrival time in London which requires connecting passengers to also make an overnight stay at the airport.

Patient Transfer Contract

- 2.11 The Isle of Man Government maintains a Patient Transfer Contract (PTC) to enable patients on the Isle of Man to transfer to hospitals on the British mainland to receive specialist treatments not available on the Island. Flybe held the PTC until their collapse in March 2020, transferring thousands of patients each year. As a result of Flybe’s collapse, an interim solution was reached with Loganair to give priority for patient transfers on their Liverpool services. A new contract was tendered for this service in July 2021 and the service is currently provided by Loganair⁸.
- 2.12 Approximately 17,000 return trips (34,000 passengers) were funded by the PTC until March 2020, when the number of trips reduced significantly due to the COVID-19 pandemic. Most patients (around 90%) used the PTC to access hospital services in Liverpool, whilst most of the remainder used the PTC to access services in Manchester. Based on these figures it is estimated that approximately 25% of Flybe passengers on the Liverpool route were funded by the PTC. In FY 2017/18 the average PTC cost per patient was **information redacted**, increasing to **information redacted** in 2018/19. Due to the requirement to run a regular service, however with a considerably lower number of patient transfers (and fewer passengers due to the pandemic) the cost per patient rose to **information redacted** in 2020/21 and is expected to reduce to **information redacted** per patient in 2021/22.
- 2.13 The PTC presents a significant contribution to operating revenues for contracted airlines on the Isle of Man to Liverpool route, and based on historical data it was determined that the route would not have been profitable for Flybe in its absence.

Impact of COVID-19

- 2.14 Since the onset of COVID-19 in March 2020 and the resultant suspension of air services throughout the British Isles, only two airlines have returned services to Isle of Man, easyJet and Loganair, largely replacing the defunct Flybe services to Birmingham, Liverpool, and Manchester. Two notable airlines that have yet to return capacity to the Isle of Man market are Aer Lingus Regional (to Dublin) and BA Cityflyer (to London City). Neither airline has indicated in future schedules that they are planning to reinstate services in the short term⁹,

⁷ One ticket from the Isle of Man to their first connecting point in the UK/Ireland and the second ticket from the connecting point to their final destination.

⁸ <https://www.gov.im/categories/health-and-wellbeing/patient-transfers/>

⁹ Based on analysis of forward looking OAG schedules (29 Oct. 21)

however it is expected that Emerald Air (the new Aer Lingus Regional franchise operator) will re-commence flights to Dublin in the medium term¹⁰.

Analysis of core routes

- 2.15 A detailed analysis of route schedules and capacity, fares and profitability, and operational performance was conducted on the “core” routes to Liverpool, Manchester and London and a summary of the outputs has been presented below. The complete analysis is provided in Appendix A.

Market overview

Liverpool

- 2.16 Liverpool has consistently been the largest market to/from the Isle of Man with 31% of passengers travelling to/from Liverpool in 2019. Liverpool’s market share has grown year-on-year since 2011 when it represented just 22% of total traffic. Between 2011 and 2019 passengers grew from 167,000 to 254,000 (CAGR+7.3%), driven in part by easyJet’s entry to the market in 2010. Average load factors have improved over the period from 55% in 2011 to 73% in 2019, partly due to capacity cuts. Two carriers, Flybe and easyJet, coexisted on the Liverpool route between 2010 and March 2020, when Flybe filed for bankruptcy. Loganair have since commenced services between Liverpool and the Isle of Man, maintaining competition as well as providing services for the PTC.

Manchester

- 2.17 The proportion of passengers travelling to Manchester has remained relatively constant at around 19-21% of passengers over the last decade. 2014 was an exception where this increased to 24%, likely due to Flybe’s withdrawal from the London Gatwick route, and a proportion of onward connecting traffic switching to Manchester. Between 2011 and 2019 passengers grew from 124,000 to 173,000 (CAGR+3.6%). Average load factors improved over the period from 58% in 2011 to 73% in 2019.

London

- 2.18 32% of passengers from the Isle of Man in 2019 travelled to London airports, with London Gatwick being the primary gateway (21%) and London City secondary (7%). Between 2011 and 2019:
- Passengers grew from 127,000 to 177,000 (CAGR+4.2%) on the **London Gatwick** route. In 2011, Flybe was the only operator on the route, and operated 3-4 daily frequencies. easyJet entered the London Gatwick market in 2013, which significantly increased capacity on the route and passenger levels increased to 184,000. In 2014, Flybe closed its base at London Gatwick, citing increased airport charges, leaving easyJet as the sole operator on the route.
 - Between 2011 and 2019 passengers on the **London City** route grew from 46,000 to 57,000 (CAGR+1.0%). Between 2011 and 2012 the route was operated by Aer Arran after which it was taken over by British Airways subsidiary BA Cityflyer. From the start of the Summer

¹⁰ Emerald Air was expected to commence operations in 2023, however due to liquidation of the previous Aer Lingus Regional franchise holder, Stobart Air, this start date has been brought forward. Emerald Air is currently establishing operations and received its Air Operators Certificate (AOC) in September 2021.

2014 season the service received financial backing from e-gaming firm ‘Microgaming’ permitting frequency growth, however this arrangement was cancelled in 2017 and service frequencies were reduced. BA Cityflyer cancelled the route in March 2020 and Loganair resumed operation of the route under its own brand. Due to the closure of London City Airport between March and June 2020, Loganair switched operations to London Heathrow, however cancelled the route in August 2021 after the government subsidy provided for the route was removed. Currently no carrier operates to London City Airport.

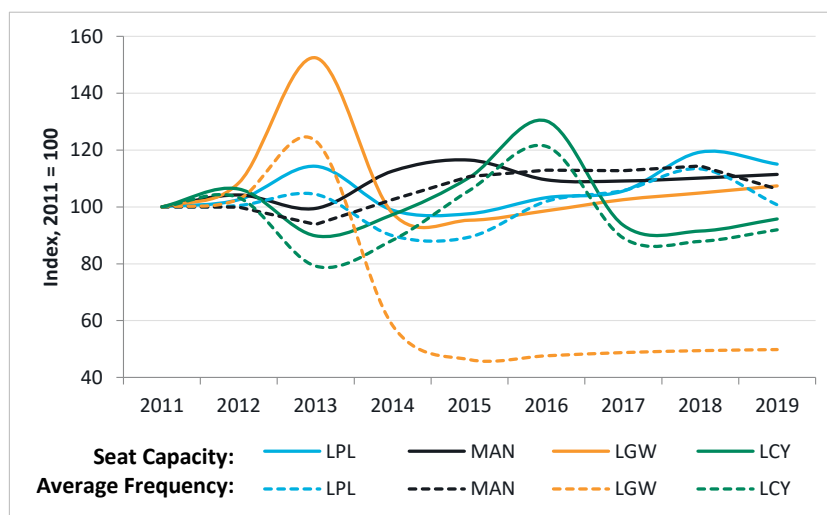
2.19 In 2019, the Isle of Man also had direct flights to London Luton (3%) and London Heathrow (2%) in the summer season. In 2019, Flybe operated a daily flight between the Isle of Man and London Heathrow for the summer season only. This route utilised a slot leased to Flybe by then parent company Virgin/Delta and was cancelled (together with Guernsey) at the end of the season.

Schedules and capacity

2.20 Figure 2.7 shows that frequency and seat capacity have varied at a similar rate since 2011 on the Liverpool, Manchester, and London City markets. Capacity on the Liverpool and Manchester routes has grown gradually since 2011, whilst the London City route has seen considerable variability primarily determined by the provision of financial support available to the service. All routes have multiple frequencies per day and some frequencies were operated by aircraft based on the Island for most of the period analysed.

2.21 Whilst capacity has also grown gradually on the London Gatwick route compared with 2011, service frequency reduced considerably after Flybe’s exit from the market. easyJet has been the sole operator on the route since April 2014 and their larger A319/A320 aircraft permit the operation of 1-2 daily rotations, representing around a 50% reduction in frequencies. easyJet does not base or overnight aircraft on the Isle of Man and all London flights are flown on an inbound basis from their London Gatwick base.

Figure 2.7: Seat capacity and average weekly frequencies - indexed



Source: OAG analyser, Steer analyser

Fares and profitability

- 2.22 The average fares on core routes to/from the Isle of Man were compared with those in other peer markets. Air fares to/from the Isle of Man were determined to generally be cheaper than those to peer markets (with a similar journey distance) based on average fares charged between 2015 and 2019. This has been presented in Table 2.1 below.

Table 2.1: Isle of Man - average fares – 2015-2019

Airport	Carrier	Average Fare ¹¹	Peer market average fare
Liverpool	information redacted	£23-£32	Jersey – Southampton: information redacted £45-£59
Liverpool	information redacted	£20-£25	Guernsey – Southampton: information redacted £40-£69
Manchester	information redacted	£27-£34	
London Gatwick	information redacted	£26-£44	Jersey – London Gatwick: information redacted £34-£42; information redacted £62-£63
London City	information redacted	£88-£98	Jersey – London City: information redacted £110-£134 Guernsey – London City: information redacted £96-£133

Source: OAG, Steer analysis

- 2.23 Comprehensive fares data for 2021 is only available up to August and due to the closure of the Isle of Man borders prior to this, average fares data is not indicative. It was found however in the month of August that average easyJet fares to the Isle of Man from Gatwick were significantly higher than those from Jersey to Gatwick (**information redacted**). Fares from the Isle of Man to Liverpool remained significantly lower than comparable fares between Jersey/Guernsey and Southampton (**information redacted**).

2.24 **Information redacted**

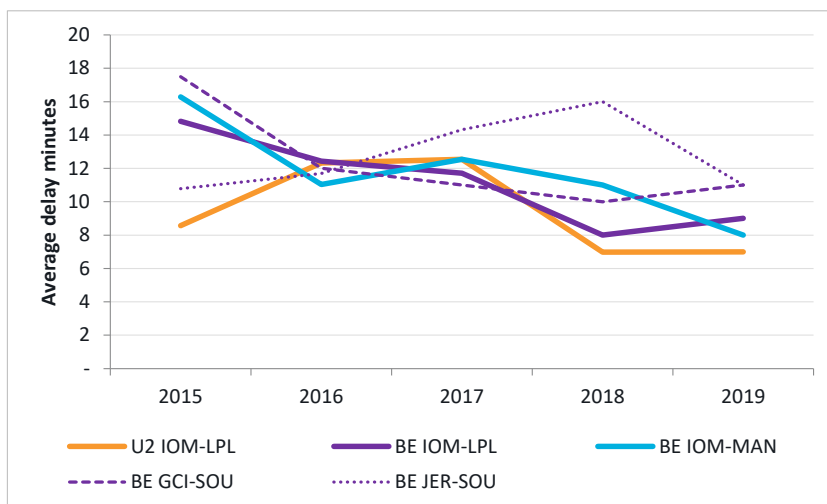
2.25 **Information redacted**

Operational performance

- 2.26 The operational performance of routes to/from the Isle of Man, obtained from the CAA, was analysed to verify whether performance differed between airlines and between peer markets
- 2.27 Figure 2.8 below shows a comparison of Flybe and easyJet’s operating performance on their Manchester and Liverpool routes with peer market routes (Jersey-Southampton, Guernsey-Southampton) in terms of average delay minutes. In 2016, delay minutes across all routes were comparable, however route performance to the Isle of Man has subsequently improved at a faster rate than in peer markets.

¹¹ Average one-way fare range between 2015 and 2019. Excludes taxes, charges and ancillary charges

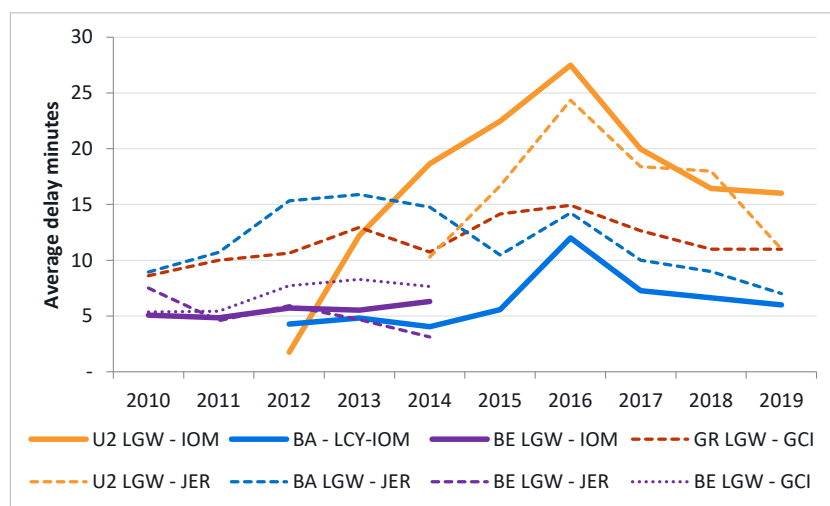
Figure 2.8: Isle of Man to Liverpool and Manchester - operating performance versus peer markets



Source: CAA, Steer analysis (U2-easyJet, BE-Flybe)

- 2.28 Figure 2.9 compares operational performance on the Isle of Man - London routes with those from peer markets Jersey and Guernsey.
- 2.29 easyJet’s operational performance on their routes from London Gatwick to the Isle of Man and Jersey share a comparable profile, with both featuring deteriorating performance until 2016 and subsequent improvements, however average delay minutes to the Isle of Man in 2019 were 16 minutes versus 11 for Jersey. The performance of British Airways (Jersey) and Aurigny (Guernsey) from London Gatwick are broadly comparable, with an average delay of 10-15 minutes and the performance of these airlines in 2016 compared with easyJet shows that easyJet’s delays were likely due to internal operational issues. Prior to their exit from London Gatwick, operational performance of Flybe’s routes was considerably better than the other airlines investigated, with an average delay of approximately five minutes. Performance of the Isle of Man route is between the performance of the Guernsey and Jersey routes.
- 2.30 BA Cityflyer’s operating performance on their London City to Isle of Man route was better than all the peer routes analysed, however also suffered from deteriorating performance in 2016. The operation of a based and dedicated aircraft on the route will have assisted with this operational performance together with lower congestion at London City versus London Gatwick.

Figure 2.9: London operating performance versus peer markets



Source: CAA, Steer analysis

Needs analysis

- 2.31 The Department for Enterprise conducted a survey to collate the views of Isle of Man residents on service requirements. Four surveys were issued for the following markets:
- Business passengers – Regional routes (non-London);
 - Business passengers – London routes;
 - Leisure passengers – Regional routes (non-London); and
 - Leisure passengers – London routes.
- 2.32 Full results from the survey can be found in Appendix C.
- 2.33 According to the 2018 Isle of Man passenger survey:
- 59% of air passengers were residents and 41% were visitors; and
 - Approximately 47% of passengers were travelling to stay in paid accommodation, 28% were visiting friends and relatives, 20% were business travellers and 6% were day trippers.
- 2.34 Connections to the North West of the UK were considered most important by business and leisure passengers in the non-London survey (46% and 57% of respondents respectively). Connections to the Republic of Ireland were considered the second most important. Frequency and timing were the most important considerations for business passengers, whilst cost was also mentioned by leisure passengers.
- 2.35 Services to either London City, London Gatwick and/or London Heathrow were cited as being most important by both Leisure and Business respondents. 72% of business respondents regarded the ability to make same day returns as either important or essential. 53% of leisure respondents preferred London Gatwick as their airport of choice. The preference for services to London Luton, Stansted and Southend was minimal (<=1%) for each airport. Cost and daily frequency were the primary considerations for leisure travellers, whilst daily frequency and reliability were primary considerations for business travellers.
- 2.36 These needs correspond to the 2019 service provision whereby around 90% of passengers were travelling to Liverpool and Manchester (50%), London (32%) and Dublin (5%). To meet the needs of the leisure and business markets, services on these routes should be maintained.

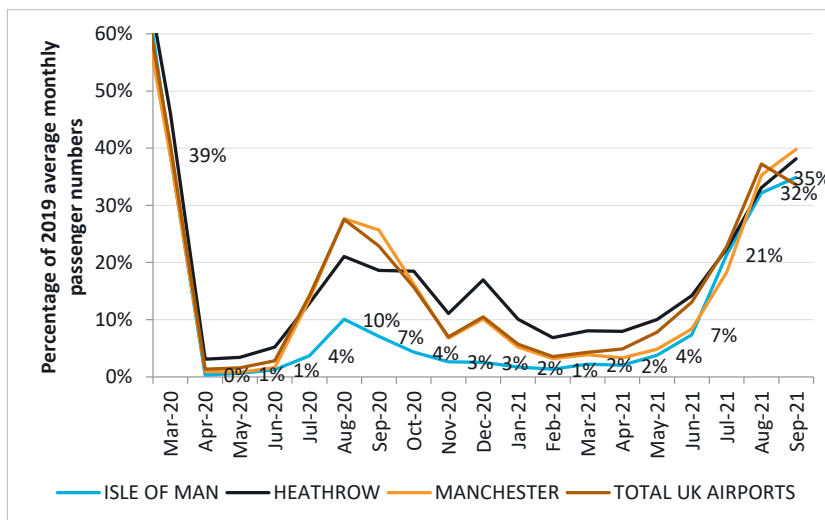
2.37 The provision of services must also be balanced to cater to both business and leisure markets as they are both significant. Business passengers are more concerned about service frequency and the ability to conduct a same-day return journey, with cost not being the primary consideration, whilst service cost was cited as a prime consideration for leisure passengers.

COVID-19 recovery

Current situation

2.38 Passenger traffic to the Isle of Man has reduced significantly due to the COVID-19 pandemic. Figure 2.10 compares monthly passengers in 2020 and 2021 against 2019 passenger statistics. Passenger traffic in April and May 2020 reduced to less than 1% of traffic in the previous year due to the lockdown. Passenger recovery lagged behind the UK average until June 2021 when passengers began to recover in line with the UK average. This can be explained by the Isle of Man’s strict border policies for all bar key workers which was lifted in June 2021.

Figure 2.10: Wider UK market – Indexed monthly passenger numbers from March 2020.



Source: CAA, Steer analysis

Outlook

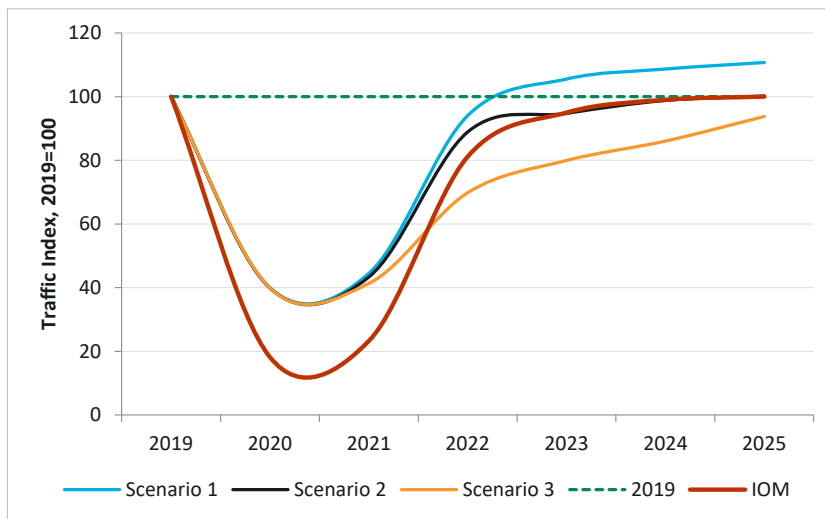
2.39 An outlook on the prospective recovery profile of traffic to/from the Isle of Man has been constructed for the purpose of reviewing policy and service options based on a review of the following:

- Recovery of the Isle of Man market after the 2008 financial crisis;
- The October 2021 Eurocontrol forecast for the UK; and
- OAG capacity scheduled to the Isle of Man for the remainder of 2021 and early 2022.

2.40 Combining data and trends from these sources it has been assumed that traffic will recover to:

- 81% of 2019 levels in 2022;
- 95% of 2019 levels in 2023;
- 99% of 2019 levels in 2024; and
- 100% of 2019 levels in 2025.

Figure 2.11: Assumed traffic recovery profile



Source: Eurocontrol, OAG, CAA, Steer analysis

- 2.41 Other “COVID-19 recovery” forecasts have been conducted by various institutions such as the International Air Transport Association (IATA), Airports Council International (ACI), Fitch ratings and Oxford Economics. Over the last 18 months they have remained dynamic and have been amended as and when appropriate, for example with the onset of new COVID-19 variant outbreaks. However, whilst they have their own analytical breakdowns of various geographies and market segments, the viewpoint that a global return to 2019 air passenger levels will be achieved by around 2024 has remained fairly consistent.
- 2.42 However, this is based on current knowledge, and should there be further damaging COVID-19 outbreaks against which the current vaccination programmes are less effective, then these forecasts may need to be reassessed.
- 2.43 There are risks to all forecasts, and this is no different. As a result of the March 2020 COVID-19 lockdown, businesses adapted to different ways of working. As an example, businesses have become accustomed to on-line meetings (MS Teams, Zoom, Skype etc). There remains a possibility that such business practices may remain, which would therefore lead to a slower recovery in business traffic, leading to a longer to return to 2019 levels.
- 2.44 Further detail on the COVID-19 traffic recovery forecast can be found in Appendix D.

3 Available policy options

Summary

- 3.1 A combination of regulatory and commercial levers provides a spectrum of approaches by which air services can be either retained, expanded, or improved. These have been outlined in Table 3.1 below, which also presents the compatibility of each of the option combinations.

Table 3.1: Available policy options

Regulatory levers → ↓ Financial levers	Open Skies	Quasi-Open Skies	Route Licencing
Commercial incentivisation	✓	✓	✓
Public Service Obligation	✓	(✓)	(✓)
Removal of Airport Passenger duty	✓	✓	✓
Establishment of a Manx airline	✓	(✓)	✓

Source: Steer Legend: ✓ Compatible, (✓) Partially compatible, - Not compatible

Regulatory levers

- 3.2 The Isle of Man has the ability to define the level to which its **market is regulated**.
- Under the current **Open Skies** agreement any UK registered carrier is permitted to fly services to/from the Isle of Man and is not subject to route, frequency, or capacity constraints. Any carrier can add capacity to the market, even if demand is not sufficient to warrant it, creating a risk of over-capacity and the loss of an incumbent operator.
 - The application of **Quasi-Open Skies** would involve designating certain routes as 'regulated' whilst maintaining the remainder of the market as Open Skies. Under this option licences would be required by carriers to operate on the regulated routes, possibly with frequency and/or capacity restrictions being enforced. These licences would be issued by the Isle of Man.
 - **Full route licencing** extends this practice to all routes from the Isle of Man; all carriers flying all routes would require a licence and might have to operate within frequency and capacity restrictions. The application of route licencing to all or some routes is a means to prevent overcapacity and predatory behaviour on routes.

Financial levers

- 3.3 The regulatory levels can be combined with the following financial levers to promote desired services:
- *Reduced airport charges and/or incentives for new routes or services* provide two ways in which **Commercial Incentivisation** on desired routes can be provided. The application of

commercial incentivisation retains the underlying principle of Open Skies competition by not restricting an airline's access to any specific route¹².

- Designation of routes as **Public Service Obligation** (PSO) would permit the IOM Government to provide an operating subsidy to a carrier to operate specified routes with defined frequency and capacity. As PSO routes can be applied to 'routes to an airport serving a peripheral or development region' it is possible that routes to the Isle of Man would qualify.
- The **withdrawal/reduction of APD** from the IOM was not determined to be an effective means to ensure services on critical routes.
- The **Establishment of a Manx airline** based on the IOM and funded by the Government, may appear to address the key issue of serving key critical destinations with an optimum schedule in terms of frequency and timings but will be by far the most expensive option for consideration. Additionally, access to London airports at optimum times would have a very low probability of success given the fact that runway and terminal capacity constraints (slots) at all key London airports (and other key European hub airports) would not allow for an optimum "business" day return schedule to be delivered. Any new aircraft fleet would likely be assigned to a 'non-optimised' network schedule putting further cost pressures on the airline's financial viability.

Regulatory levers

Maintain an Open Skies aviation policy.

- 3.4 The EU Liberalisation III Package in 1993 (known as Open Skies) created a single aviation market in Europe that in turn allowed any EU registered airline to operate passenger and/or air freight services between any destination within the EU without the need to obtain a route authorisation approval. The introduction of Open Skies, coupled with the advent of the internet and the evolution of low-cost airlines, revolutionised air travel within Europe providing increased connectivity and reduced fares for the majority of consumers. Airlines have also benefitted from increased levels of flexibility to quickly and easily adjust their route networks, frequency of service, and air fares to primarily boost profitability.
- 3.5 Whilst in general, Open Skies has been deemed beneficial to the majority of European consumers, the lack of a regulatory regime can also result in market instability, especially in smaller markets. Airlines are primarily operated for profit and carriers will seek out opportunities to maximise this, especially when aircraft, and slots at desired airports are finite resources.
- 3.6 The ability for airlines to compete is primarily a function of their cost-base, which is influenced by their ability to negotiate favourable aircraft finance/leases, airport charges, staff salaries and terms and conditions, fuel hedging and back-office functions. The economies of scale of larger carriers, together with the lower cost and non-legacy staff sought by low-cost airlines permit them to have a considerably lower cost-base than regional and legacy airlines.
- 3.7 Regional carriers are essentially protected in small markets where demand and/or infrastructure restrictions do not permit competition with larger carriers, however in locations such as the Isle of Man, where both demand and runway length permit the operations of larger carriers, regional carriers are placed at risk owing to their higher operating cost base. As

¹² However it would be compatible with the other forms of regulation stated.

smaller markets develop there is also nothing preventing a larger carrier identifying this potential and introducing capacity to the route to outcompete the incumbent carrier.

- 3.8 An Open Skies policy does not ensure consistent services on critical routes, rather market forces dictate which services operate and when.
- 3.9 The simple maintenance of the status quo would likely leave the route network from the Isle of Man in a position of stasis, and notably with an irregular single/double daily service to London Gatwick and a seasonal service to London Luton (primarily aimed at the leisure market). Market attempts to operate other London services profitably (notably to London City) have not been sustainable without additional intervention.
- 3.10 This risk extends to airports as many have fixed high-cost assets and regional dependency and can often find themselves at a significant loss in terms of regional connectivity when an airline switches out an aircraft to operate another route for improved commercial or operational reasons.
- 3.11 Where Open Skies does not entice an airline to operate a service, and that service is deemed critical in terms of connectivity for a region, then seeking a route to be designated as a Public Service Obligation (PSO) may merit consideration as outlined in paragraph 3.41 below.

Introduction of a “Route Licencing” regulatory regime.

- 3.12 If the Open Skies policy was to be replaced with a route licencing scheme, a new regulatory regime would need to be introduced by the IOM Government. A route licencing scheme could be applied to all services operating to the IOM, or a hybrid version (“Quasi-Open Skies”) could be introduced, applying a route licence only on a selection of route(s) that are deemed critical to the IOM. The introduction of a route licence on a key route such as London Gatwick could be assigned to an airline in conjunction with an agreement that required it to deliver certain criteria such as:
- Frequency of service;
 - Times of operation;
 - Establishment of a based operation;
 - Fare caps;
 - Minimum level of seat capacity per departure; and
 - Any other key criteria as deemed necessary.
- 3.13 There is a risk that the introduction of any form of “light touch” regulation on a route that is already served, for example from the Isle of Man to London Gatwick, may be challenged by an incumbent airline or may trigger some unforeseen consequences, for example the withdrawal of services on other routes by the incumbent airline or a legal challenge on competition grounds for loss of future revenues. However, there may be less risk if any form of “light touch” regulation were to be applied to non-served routes such as London Heathrow. For these reasons, further specialist competition law advice would need to be sought.
- 3.14 The process for the introduction of a new aviation policy such as route licencing would need to be managed within the IOM Government, or independently, and would need to ensure a level of transparency in terms of the criteria being assessed. An early dialogue would be required with the UK’s CAA Route Licencing department to ascertain how the regulated routes to the IOM would be designated by the UK as all routes between the UK and non-European Economic Areas (EEA) are limited by bilateral Air Service Agreements and would need to be designated by the Secretary of State under the terms of the Air Service Agreement.

- 3.15 A hybrid model where an Open Skies policy is retained for all services apart from routes deemed as critical could prove an innovative approach and worthy of further evaluation especially from a legal/competition law perspective.

Financial levers

Commercial Incentivisation

- 3.16 There are two key areas where airlines can be supported commercially for operating air services:
- reduced airport charges; and
 - incentives for new routes or services.
- 3.17 Both of these are primarily delivered via a comprehensive key account management process between the airport and the airline.
- 3.18 The overarching principle in offering commercial incentives is that they are not anti-competitive. As a guiding principle to ensure incentives are not anti-competitive, they should be made available to all airlines, or when only offered to a single airline it should be time limited (for example as a start-up incentive for say 3-5 years on a tapered basis).

Aeronautical Charges

- 3.19 Aeronautical charges and financial incentives can act as a mechanism to encourage new services or increase frequencies to the IOM. There are a range of options that an airport can consider when reviewing its aeronautical pricing policy that deliver shareholder value in a non-discriminatory manner and at the same time focus on the needs of key airline sectors/aircraft types.
- 3.20 The introduction of variable charges and fixed charges align cost recovery with asset utilisation. For example, an all-inclusive per passenger charge for all airport services may be excessive for certain aircraft sizes but advantageous for others dependant on load factor. Variable charges can be aligned to an aircraft's Maximum Take Off Weight (MTOW) and by aligning individual charges for the runway, parking, and Air Traffic Services to a rate per tonne generally provides a more equitable charging basis for smaller regional aircraft than heavier jet aircraft. Tariffs levied on a per passenger basis are usually aligned to those services that are provided equally to everyone, for example, terminal related charges or passenger security processing charges.
- 3.21 Peaking characteristics, either daily, weekly, or seasonally can also be integrated into an aeronautical pricing policy through peak pricing or off-peak pricing for both fixed and variable tariffs where factors of efficiency (e.g. opening hours) can be rewarded through lower tariffs or inefficiency through higher tariffs.
- 3.22 In addition to a review of the aeronautical pricing policy, the industry norm for stimulating and retaining air services is for airports to offer a range of commercial incentives (this is addressed in the Aviation Development section below).

Aviation Development – Key Account Management

- 3.23 Aviation development at an airport is a critical component in maintaining and developing the business cycle of airlines growing their business through an airport. The reality is that there is always a level of churn at airports as airlines merge, fail, or withdraw services for alternative

use as routes may become unprofitable or commercial agreements with an airport cannot be reached.

- 3.24 A key element at any airport is to have an aviation development function that is fully aware of the route performance issues at its airport and to be constantly building a future pipeline of realistic new business opportunities to add to the existing network in a sustainable manner.
- 3.25 Airlines are continually approached by airports pitching for new business and this global phenomenon has been fuelled over the past 20 years through a combination of airport privatisations and the continued rapid growth of low-cost airlines. The majority of successful airport privatisations are achieved on the realisation of aggressive passenger growth forecasts. Delivering such aggressive passenger forecasts are primarily achieved through an account management process by an airport's aviation development team that have established a regular and proactive dialogue with an airline's network development team.
- 3.26 Commercial agreements can take many forms but generally are a trade by the airport for a discount on charges and a contribution towards marketing activity for a guaranteed level of throughput of passengers or frequency of services/seat capacity by the airline.
- 3.27 An indicative future pipeline of aviation development activity for IOM would be to work with all potential airlines who have the ability to replace services to destinations that have fallen away post COVID-19. In addition, as easyJet and Loganair are the principal operators to the IOM there may be a desire, if not already in place, to establish a joint aviation development network development plan that is mutually rewarding for both airlines.

easyJet

- 3.28 Based on our own analysis, a strategic objective for easyJet services to London could be to secure double daily services at business-friendly times to allow a day's business activity to take place in both London and IOM.
- 3.29 The current Winter 2021 flight schedule does not offer day return flights and has a flight schedule that is not consistent in terms of timing every day. The Summer 2022 schedule, that is now on sale, shows that day return flights are available with good timings for business travel ex London Gatwick and reasonable/poor timings for business travel ex IOM, which are both a consequence of the aircraft operating the service being a London Gatwick based aircraft.
- 3.30 If a more competitive schedule were to be sought from easyJet to cater more for the IOM business community it could be achieved by a retime of the morning services to depart LGW earlier, or would need to focus on an IOM based aircraft or linking a Liverpool or Manchester early morning service to London Gatwick as described below:
- When Flybe withdrew services from Inverness to London, Inverness Airport agreed a 5-year commercial agreement with easyJet to secure a twice daily service from Inverness to London Gatwick with flight times scheduled to accommodate the business needs of a day return trip. This shows that easyJet may be open to such an agreement to operate an overnighting aircraft at the IOM with non-based crews that would incur incremental overnight hotel, transportation, and crew costs.
 - Due to the short sector length between Liverpool/Manchester and the Isle of Man an early morning rotation to London could be operated by an aircraft based at either of these airports. A Liverpool (LPL) or Manchester (MAN) based aircraft with a departure from LPL or MAN (circa 06:00) would allow for a departure ex IOM approx. 07:00 to arrive in LGW approx. 08:15.

- A retime of the existing planned schedule for Summer 2022 which could be a least cost option.

- 3.31 For an airline to initiate a base, a minimum of 2 or 3 aircraft is usually considered a key criterion. Opening a base with a single aircraft is considered unlikely (for crewing and maintenance reasons) and so an overnighing aircraft (non-based) would require its operating crew of 5 or 6 to need hotel and transportation each night adding cost to its operation – est. £150-£200k p.a. for hotel and transport costs before any flight crew pay est. £350-£500k p.a. Therefore, an alternative more cost-effective strategy could be to incentivise easyJet to deploy an aircraft based at one of its nearest bases (LPL or MAN) to operate an early morning departure ex IOM to LGW (having already operated an earlier flight from LPL or MAN). This operating pattern could be constructed so that the late evening departure ex LGW to IOM then returns to the original base LPL or MAN thereby providing a day return service from that destination. A commercial agreement that is constructed around a core objective of delivering a day return service from IOM to LGW using an aircraft from LPL or MAN could provide the added advantage of delivering a second day return business orientated service to another key destination, either LPL or MAN.
- 3.32 Given that easyJet currently plans to operate a twice daily service from LGW to IOM from the end of March 2022, an easier and more cost-effective engagement strategy with easyJet may be to incentivise an earlier departure from LGW.
- 3.33 The easyJet service from Manchester is a potential cause for concern. Whilst the additional volume of seat capacity entering the market from the North West is welcome, it may prove to be too much capacity at such competitive prices that could lead Loganair, the incumbent, to consider whether their high frequency services on the IOM-MAN sector are commercially viable. For the Winter 2022 season the easyJet IOM-MAN services are not daily and whilst slots may well be submitted for daily Summer 2022 services (to be confirmed in the very short term) the IOM full tariff structure may act as a deterrent if no commercial incentive was to be offered for this service.

Loganair

- 3.34 Based on information received from the airline, Loganair are understood to have an appetite and capability to serve the London market from IOM with the basing of a 3rd aircraft on the Island. A provisional operating pattern for this 3rd aircraft would see a double daily service to London City Airport and a mid-day service to London Heathrow with all services operating with a British Airways codeshare, thereby providing through ticketing and baggage services for worldwide flights from the IOM.
- 3.35 Securing such advantageous services for the business and leisure market sectors is likely to require some form of subvention from the IOM Government in the form of regulatory licensing, commercial incentives or changes to the airport charging structure to make the services commercially viable.
- 3.36 The introduction of a route licence on each of the London airports (London Gatwick and London City) would allow airlines to bid for the licence and once obtained provide a level of assurance for operating on that route having invested a significant amount of resource and money establishing that route. The introduction of licensing “requirements” such as an early morning departure from the IOM to avail of the license and any associated discounted airport tariff would act both as a support mechanism for a based operation and an incentive to

encourage later departing flights to London (such as the planned easyJet LGW Summer 2022 service) to reschedule to an earlier departure.

- 3.37 The most significant barrier to entry for securing direct flights to London Heathrow is securing runway and terminal access rights “slots” at the airport at optimum times. Given the significant downturn in traffic during the past 18 months airlines, such as British Airways, may be open to “leasing” slots to other airlines such as Loganair and given that British Airways have agreed a codeshare arrangement with Loganair for their new services from Teesside there may well be an opportunity for that arrangement to be extended for Loganair to commence services from the IOM to London Heathrow on a double daily basis. The duration of such an operation would no doubt be limited to the length of time Loganair can secure the available slots.
- 3.38 With services to London considered a high priority for the IOM and not wanting to be totally reliant on one carrier (given a scenario that a double daily service does not operate on a year round basis) or if Loganair was unable to gain suitable slots at London Heathrow and codeshare rights with British Airways, nurturing an engagement strategy with British Airways (Heathrow and BA’s new lower cost subsidiary at Gatwick), British Airways Cityflyer (London City) and Wizz Air (London Luton and Gatwick) would all be considered a priority in terms of engagement and developing a sales pipeline if not already in place.

Other Routes

- 3.39 Other key route prospects for both point to point services and hub connections would be Dublin (through new Aer Lingus franchise partner Emerald Air); Paris (Air France); Amsterdam (KLM); Brussels (Brussels Air) and Frankfurt/Munich (Lufthansa).
- 3.40 Reinstating Aer Lingus services to Dublin – primarily through franchise partner Emerald Airways that will operate ATR 72 turbo-prop aircraft - is considered a particular strategic short-term objective. Aer Lingus is part of the International Airlines Group (IAG) who also own British Airways, Iberia, Vueling and Level. Aer Lingus offers a wide range of transatlantic connections via Dublin and also operate multiple daily frequencies to London Heathrow airport that connect onto BA’s comprehensive network there (albeit a direct service to London Heathrow is of course the preferred option).

Public Service Obligation (PSO)

- 3.41 Where an Open Skies or a route licencing regime does not generate any interest from an airline to operate a route deemed critical by the IOM Government, the option may exist to initiate a tender process for a PSO route that is effectively funded by the IOM Government through tendered grants which pick up the monetary shortfall given that such routes make little or no money and can even be loss making. The term PSO route is aligned to EU Regulations that determine whether such a route meets key criteria as outlined in Appendix E. Given that a double daily service to London from the IOM is regarded as a critical service for economic purposes and that a daily service to London Gatwick exists, it would appear that on the face of it, seeking a PSO route to any London airport would fail the tests as determined within EU policy.
- 3.42 However, given that the IOM is not in the EU but complies with overall EU Aviation Policy, further advice would need to be sought should the IOM Government seek to provide PSO funding to a route.

3.43 Given a scenario where a light touch route licencing policy was introduced on a critical route such as IOM-London Gatwick the need for a PSO service to London would not be needed given that there is sufficient market demand already in place.

3.44 Details of the EU process for determining route eligibility for PSO status is described within Appendix E.

Air Passenger Duty (APD)

3.45 Consideration as to the impact that the abolition of APD would have on stimulating additional network growth is a factor worthy of consideration. Given a significant reduction in passenger throughput as a consequence of COVID-19 there will have been a corresponding reduction in APD revenue generation. From April 2023 the APD on UK Domestic flights will be reduced by 50%, equating to a drop from £13 to £6.50 per departing passenger.

3.46 Abolishing APD altogether should in theory reduce air fares and thus stimulate demand on the outbound sector from the IOM but this assumes that airlines reflect its withdrawal within the airfare. Should the airline not reduce air fares, then this could improve the profitability of the incumbent air service without stimulating demand.

Establishing a Manx airline / franchise carrier

3.47 There are many benefits for establishing a new Manx Airline, primarily to provide:

- Frequencies of services at levels desired by the local community;
- Connectivity to destinations that other airlines are not prepared to operate.

3.48 There are considerable costs involved and there are further options to consider in contracting another established airline with an existing Air Operators Certificate to undertake such services. This latter option is usually referred to as an ACMI (Aircraft, Crew, Maintenance & Insurance) operation.

3.49 One of the primary challenges a new airline would face in developing key routes that are considered of strategic importance would be securing slots at congested airports at optimum times for multi day services.

3.50 Acquiring optimum pairs of “slots” at congested airports at peak times (primarily all London Airports) is considered the greatest challenge and obstacle in establishing a new airline. Whilst there are certain slot allocation rules that give preference to “new entrants” at slot congested airports, the availability of new slots at congested airports being created once normal traffic levels resume post COVID-19 is remote. Slots at congested airports are sometimes traded or leased for considerable sums of money and the economic benefit of embarking on such a strategy for what may be a relatively short period needs to be evaluated. Some examples of slot trades and their value are included in Table 3.2 below.

Table 3.2: Example of slot trades at LHR and LGW

Year	Airport	Sell-side	Buy-side	Daily Slots Pairs	Transaction cost
2020	LHR	Air New Zealand	Not disclosed	1	US\$27m
2019	LGW	Flybe	Vueling	3	£4.5m
2017	LHR	SAS	American	2	£60m
2016	LHR	Kenya Airways/AFKLM	Oman Air	1	£58m

Source: Public news sources

4 Option development and impact

Summary

- 4.1 The provision of services on routes to Liverpool, Manchester, London (London City, Gatwick, Heathrow) and Dublin was considered as critical to both business and leisure passengers based on the market analysis conducted and from information provided in the needs analysis.
- 4.2 A series of **financial options**, or levers, have been developed and quantified based on the policy options identified in section 3. These include:
1. Retaining the current situation;
 2. Targeted route financial assistance;
 3. Removing APD; and
 4. Establishing a Manx carrier.
- 4.3 Options 2-4 can be supported with the following **regulatory measures** if necessary:
1. Transition to quasi-Open Skies with critical routes requiring licences for operation; or
 2. Transition to a fully regulated market with all routes requiring licence for operation.
- 4.4 Where possible, costs and benefits have been quantified to support each option relative to the current situation. Qualitative benefits have also been included to ensure that the needs and requirements from the stakeholder consultation have been addressed, indicated as a star rating for the business and leisure segments. The costs associated with the policy options represent the financial assistance required to cover route losses incurred and the financial impact of removing APD, together with revenues from any derived benefits. These are presented in Table 4.1 below.

Table 4.1: Summary of options

Option			Total Annual Cost (£m)	Qualitative Benefits			Notes
Route	Airport/ Airline/ Daily Frequency	Business		Leisure	Notes		
Retain current situation			<i>Information redacted</i>	-	-	No change.	Issues not addressed.
Targeted route financial assistance	Liverpool	-	<i>Information redacted</i>	-	-	No change.	Maintain status-quo.
	Dublin	-	<i>Information redacted</i>	-	-	No change.	Maintain status-quo.

Option			Total Annual Cost (£m)	Qualitative Benefits			Notes
	Route	Airport/ Airline/ Daily Frequency		Business	Leisure	Notes	
	Manchester	Regional carrier x 4	<i>Information redacted</i>	+++	+	Enhanced onward connectivity.	No financial assistance given. Benefits from 1 based aircraft.
	Manchester	LCC x 1 Regional carrier x 2	<i>Information redacted</i>	++	++		No financial assistance given. Benefits from 0.5 based aircraft.
	London	LGW x 3	<i>Information redacted</i>	+	++	Regular service.	Reliance on one airline.
	London	LGW x 2 LHR x 2	<i>Information redacted</i>	+++	++	Regular service. Improved connectivity. Appeals to all consumers.	LHR charges from 2022. Long term slot accrual issues at LHR. LGW inbound. LHR based.
	London	LGW x 2 LCY x 2	<i>Information redacted</i>	++	++	Regular service. Some improved connectivity. Appeals to all consumers.	LGW inbound. LCY based.
Removal of IOM APD (£13)			<i>Information redacted</i>	-	+	Limited impact.	No guarantee of improved service provision.
Removal of IOM APD (£6.5)			<i>Information redacted</i>	-	+	Limited impact.	No guarantee of improved service provision.
Establishment of a Manx Airline			High	+++	+		Most expensive option.

Source: Steer analysis and assumptions

4.5 The compatibility of each of the options with the regulatory options identified has then been considered. If financial support for service development is offered, the implementation of Quasi-Open Skies (a licencing scheme for specific routes only) could be considered to remove the risk of additional, potentially predatory competition, providing a carrier with a degree of longer-term certainty. Incumbent carriers should be included within such agreements.

Table 4.2: Summary of regulatory compatibility

	Open Skies	Quasi-Open Skies	Route Licencing
Retain current situation	No change	NA	NA
Service development support <ul style="list-style-type: none"> ➤ Commercial incentivisation ➤ PSO 	Services on critical routes can be financially supported but additional competition	Services on critical routes can be financially supported and additional competition can be controlled.	Services on critical routes can be financially supported and additional competition can be controlled.

	Open Skies	Quasi-Open Skies	Route Licencing
	cannot be directly controlled. Competition can be indirectly controlled by not offering the same levels of financial support.	Free market on other routes permits their development where the market supports them.	Licencing on other routes may restrict their development. Free market on other routes permits their development where the market supports them.
Removal of IOM APD	Compatible but no focussed benefit.	Compatible but no focussed benefit.	Compatible but no focussed benefit.
Establishment of Manx airline	Not Compatible. Cost base not competitive against competition.	Operational routes will need to be licenced to exclude/control competition.	Would prevent leakage in some at-risk markets.

Source: Steer analysis and assumptions

4.6 Having considered the size of the markets and their importance to the Island, the needs of the business and leisure markets and the various policy options, the preferred solutions for the various markets may vary, given the different dynamics and current competitor situations that exist in the various markets. However, the table below provides a summary of some of the preferred solutions that could support the required development of services in each of these four core markets.

Table 4.3: Summary of potential options for route development on core routes

Destination Market	Required change to network offering	Additional financial support required	Regulatory regime applied	Net Cost (£m) ¹³
Liverpool	None.	None.	Open Skies. Route operates sustainably with two carriers (provided PTC contract is maintained). Should the status-quo change and there is a risk of external predatory behaviour then route licences for incumbent airlines should be considered.	<i>Information redacted</i>
Manchester	Choice between high frequency regional service, enhancing connectivity or low-frequency option with mainline aircraft.	Only through airport charges. Possible opportunity to extend the scope of the PTC contract to include services to MAN for operator to provide multiple daily services	Open Skies, but if financial incentives/disincentives are not enough to influence optimal network, then consider	<i>Information redacted</i>

¹³ These are the net costs associated with sustaining a service that will break-even and associated costs can be covered though commercial incentivisation or with a PSO agreement. Liverpool (with PTC), Manchester and Dublin have historically operated profitably without direct financial support.

Destination Market	Required change to network offering	Additional financial support required	Regulatory regime applied	Net Cost (£m) ¹³
	Market unlikely to sustain both.		the application of a route licence ¹⁴ .	
London	Additional capacity and frequency of services required. Ideally additional airport destinations (LCY/LHR) required.	Yes – additional financial support likely.	Application of route licencing for LGW, LCY and LHR, providing protection for incumbent and/or new carrier to operate without fear of additional competition on the route.	Information redacted
Dublin	New service required. Likely awaiting Emerald Air (Aer Lingus) to grow after its accelerated start-up.	Only through application of lower airport charges to secure the reintroduction of a new service, combined with start up support	Open Skies. Route likely to return when market demand returns, likely operated by just one carrier.	Information redacted

Source: Steer analysis

Service requirements

- 4.7 The provision of services to Liverpool, Manchester, London, and Dublin was determined as critical to both business and leisure passengers based on the market analysis conducted and also from information provided in the needs analysis. These four destinations are economically and socially critical for the Island, accounting for around 90% of all travel needs, and for this reason, some form of protection should exist around them to prevent predatory action.
- 4.8 The ability for connections to be made must also be considered. London Heathrow, Gatwick, Manchester, and Dublin all provide connection points for international connectivity.

Liverpool

- 4.9 The Liverpool market has maintained competition for the last decade with easyJet and Flybe historically offering a combined schedule of up to 5 flights per day. Currently Loganair operates the route twice daily and easyJet once daily; it is expected that both airlines will continue to grow frequencies back to pre-COVID-19 levels as traffic demand recovers.
- 4.10 Loganair currently hold the PTC, which primarily caters to hospital patients travelling to appointments in Liverpool. Pre-pandemic PTC passengers accounted for around 25% of Flybe's passengers on the Liverpool route. The requirements of the PTC essentially require an aircraft to be based on the Isle of Man to operate flights to Liverpool at the required time and the revenues provided through it permit the viable operation of the route with multiple daily frequencies in competition with easyJet.

¹⁴ A route licence should only be issued when the preferred carrier is operating the route solely. Currently this is not possible as two carriers are operating on the route.

Service options

- 4.11 The current arrangement on the Liverpool route has permitted competition and has maintained frequencies on the routes together with the ability for day returns suited to business travellers. No change to the current financial arrangements on this route is required.
- 4.12 If there is a risk of new competition, this can be dissuaded with by not providing reduced passenger charges at the Isle of Man, or by designating the route as a licenced route, with licences being issued to the two incumbents.

Manchester

- 4.13 The Manchester market was solely operated by Flybe until the airline filed for bankruptcy in March 2020, who had offered up to five flights per day. The route has been operated by Loganair twice daily over the summer 2021 season, and since November 2021, easyJet has also commenced daily flights to Manchester in competition with Loganair. Manchester is a primary point for passengers making onward connections from the Isle of Man
- 4.14 In 2019, the route served 173,000 passengers, equating to an average of 237 per day. In the current environment, where demand is considerably lower this market entry has the potential to create a severe risk of overcapacity on the Manchester route. At pre-COVID-19 traffic levels this would permit the profitable operation of:
- 4/5 x daily ATR72 aircraft; or
 - 1 x daily A319 aircraft and 2 x daily ATR72 aircraft.

Service options

- 4.15 The Manchester market is currently not big enough for two carriers and easyJet's entry into the market could dissuade another carrier from adding additional frequency into the market.
- 4.16 It was mentioned that easyJet were not offered discounted passenger charges for passengers on this route, however the airline still decided to continue with its launch. Lead in fares for the service are as low as **Information redacted**, 50% of the combined cost of APD and passenger charges payable on departure from the Isle of Man. It is understood that Loganair have filed a formal complaint on the basis of this being predatory pricing. There is a risk that it would likely not develop its own service against this competition.
- 4.17 It should be noted that easyJet currently has tickets from the Isle of Man to Liverpool and London Gatwick on sale for the Summer 2022 season, however tickets to Manchester are not on sale despite having applied for slots to operate the service. It may be the case that easyJet is seeking to renegotiate passenger charges for the service before committing to its operation in the summer season.
- 4.18 The Manchester market has previously not required direct financial intervention to be operated profitably. Assistance was likely provided to airlines through reduced passenger charges at the Isle of Man. Competition should not be necessary on this route to control excessive pricing due to the proximity of Liverpool Airport.

London

Airports

- 4.19 The Isle of Man Government questionnaire showed that over 90% of respondents considered services to London City, Gatwick, or Heathrow to be the most import for business, of which

more than half preferred London City. 72% of respondents regarded the ability to make same day returns as either important or essential. 53% of leisure respondents preferred London Gatwick as their airport of choice. The preference for services to London Luton, Stansted and Southend was minimal (<=1%) for each airport.

4.20 Based on this information, services to either London City, Gatwick and Heathrow were considered critical services for both the business and leisure markets, whilst services to other London airports were considered as adding a level of additional choice but not as critical to the connectivity to residents. Only services to London City, Gatwick and Heathrow are considered in the option analysis for London.

Service options

4.21 To enable both the environmental and financial sustainability of operations, the capacity of operations with different aircraft types has been aligned with perceived demand. In order to provide sufficient capacity on the London route to satisfy the market demand, either the following combination of flights should be secured to a:

- Three times daily flight with ‘mainline¹⁵’ aircraft to either London Gatwick or London Heathrow; or
- A twice daily flight with ‘mainline’ aircraft to either London Gatwick or London Heathrow and a twice daily flight with a regional aircraft to either London Heathrow or London City (serving two different airports). Further frequencies could be possible depending on the usage of the London route by passengers with connections to onward destinations.

4.22 The London market is sufficiently large to support two carriers, however the London City route has required financial intervention in recent years to safeguard a business-friendly schedule. After Loganair’s withdrawal from the London market in August 2021 due to the withdrawal of its operating subsidy it unlikely that another airline will return to the London City or London Heathrow market without intervention despite demand existing for the service.

4.23 The costs associated with operating various service combinations were calculated for a variety of aircraft types on the route between the Isle of Man and London Heathrow, London Gatwick and London City and a summary of the options considered is presented in Table 4.4. Further information, including the methodology, sources and assumptions used can be found in Appendix F.

Table 4.4: London route options

Aircraft type	Mainline	Regional	
Airport	Gatwick	Heathrow	London City
Airline	LCC	Regional	Regional
Potential airline	easyJet	Loganair	Loganair
Principle	Incumbent, maintain low-cost service	Improved connectivity to supplement low-cost service	Business connectivity

¹⁵ Mainline aircraft refers to A319/A320 or B737 sized aircraft, which have capacity for 150-186 passengers

Aircraft type Airport Airline	Mainline Gatwick LCC		Regional Heathrow Regional	London City Regional
	Frequency (daily) ¹⁶	2	3	2
First departure aircraft	Overnight	Overnight	Base	Base
Assumed aircraft	A319	A319	ATR72	ATR72
Annual Capacity ('000 seats)	220	300	99	99
Cost of service ¹⁷ (annual £m)	<i>Information redacted</i>	<i>Information redacted</i>	<i>Information redacted</i>	<i>Information redacted</i>
Average cost per seat ¹⁸	<i>Information redacted</i>		<i>Information redacted</i>	<i>Information redacted</i>
Strengths	easyJet has a large slot portfolio at London Gatwick. Cheapest cost per passenger. Improving current service.		Can supplement LCC service to Gatwick without creating overcapacity in the market.	Can supplement LCC service to Gatwick without creating overcapacity in the market. London City favoured by business passengers in needs analysis.
Weaknesses	easyJet does not codeshare.		Loganair does not possess any slots at Heathrow and will have to lease slots from other carriers when the slot waiver is renounced.	Highest average cost per passenger.
Opportunities	New schedule will assist with direct transfers at Gatwick. easyJet currently has an abundance of slots.		Loganair has a codeshare agreement with British Airways at Heathrow on Teesside services. A similar agreement could be reached for the IOM route.	Slots at London City are available from the pool (even at peak times). LG indicate desire to operate flights with a BA codeshare.

¹⁶ Frequency on weekdays. Saturdays – 1 daily flight winter, 2 daily flights summer. Sunday 2 daily flights. Frequencies per year 1x: 364, 2x: 705, 3x: 963

¹⁷ Excludes APD and Airport passenger charges (applied per passenger rather than per operation)

¹⁸ Includes APD and published airport passenger charges

Aircraft type	Mainline	Regional	
Airport	Gatwick	Heathrow	London City
Airline	LCC	Regional	Regional
Threats	Slots may be moved to more profitable routes as traffic returns to pre-pandemic levels.	In the short-term carriers are more willing to lease slots but may wish to take them back as traffic returns to pre-pandemic levels.	

Source: Steer analysis and assumptions

Dublin

- 4.24 The Dublin service has been maintained without direct financial intervention and it has been assumed that this service was profitable. It is assumed that Emerald Air will restart services to the Isle of Man under to Aer Lingus Regional brand under similar conditions to when the route was operated by Stobart Air.

Option costs

- 4.25 A series of financial options have been developed and quantified based on the policy options identified in section 3. These include:
1. Retaining the current situation – Open Skies;
 2. Targeted route financial assistance;
 3. Removing APD; and
 4. Establishing a Manx carrier.
- 4.26 Options 2-4 can be supported with following regulatory measures if necessary:
5. Transition to quasi-Open Skies with critical routes requiring licences for operation; and
 6. Transition to a fully regulated market with all routes requiring licence for operation

Retaining the current situation / Open Skies

- 4.27 The cost of maintaining the current situation was assumed to have zero cost. This assumes that current airport charge discounts are maintained.

Targeted financial assistance

- 4.28 The costs associated with supporting desired routes and frequencies have been calculated for the London route as this route has historically required financial intervention to maintain a high frequency service. Direct financial intervention has not been required on other routes and it has been assumed that they can continue to be operated profitably provided that available capacity corresponds to demand.
- 4.29 Cost associated with overnighting non-based aircraft to provide a suitable schedule and benefits from salaries paid for the operation of based aircraft have been included.

APD removal

- 4.30 The removal of APD is not influenced by the regulatory options but must be applied to all passengers in the same manner if a discount is constructed in this way (non-discriminatory).

Associated benefits from stimulated visitor expenditure and airport charge revenues have been included.

Establishment of a Manx airline

- 4.31 Whilst the establishment of a Manx airline would be compatible with all the regulatory options explored, the airline would likely not be competitive in an Open Skies market and would require both financial and regulatory assistance to operate sustainably.
- 4.32 The operation of based/overnighting aircraft is a requirement to ensure that well timed and frequent services can be offered. If aircraft are based, additional economic benefits for the Island can be derived from the use of local crews and maintenance facilities.
- 4.33 Encouraging an established airline to base/overnight aircraft on the Isle of Man has considerable advantages over establishing an airline, including:
- Considerably reduced set up costs;
 - No requirements to obtain an airline Air Operators Certificate (AOC);
 - The ability to utilise airline economies of scale and stronger negotiating power to reduce operating costs;
 - The ability to utilise any relationships the airline may possess in terms of establishing codeshares or ability to lease slots at constrained airports; and
 - Increased flexibility to add/remove aircraft to cater to demand.
- 4.34 Economies of scale generated through the basing of multiple aircraft needs to also be considered generated by crewing, scheduling, and maintenance efficiencies.
- 4.35 The costs associated with each of the options have been estimated in Table 4.5 below. The costs represent costs incurred in 2019 under the various options relative to the current Open Skies situation that was in place (Costs associated with retaining the current situation are assumed to be zero).

Table 4.5: Cost and impact of options

Option		Option Cost (£m)	Overnight costs (£m)	APD (£m)	Airport Charges (£m)	Visitor Revenues (£m)	Direct benefits (£m)	Net Cost (£m)	Qualitative Benefits			Notes	
Route	Airport/Airline								Business	Leisure	Notes		
Retain current situation		£ -	NA	£ -	£ -	£-	£-	redacted	-	-	No change	Issues not addressed	
Targeted route financial assistance	Liverpool		£ -	£ -	£ -	£-	£-	redacted	-	-	No change	Maintain status-quo	
	Dublin		£ -	£ -	£ -	£-	£-	redacted	-	-	No change	Maintain status-quo	
	Manchester	Regional carrier x 4	£ -	£ -	£ -	£-	£-	redacted	redacted	+++	+	Enhanced onward connectivity	Benefits associated with 1 based aircraft
	Manchester	LCC x 1 Regional carrier x 2	£ -	£ -	£ -	£-	£-	redacted	redacted	++	++		Benefits associated with 0.5 based aircraft
	London	LGW x 3	redacted	redacted	£ -	£ -	£ -	redacted	redacted	+	++	Regular service	Reliance on one airline
	London	LGW x 2 LHR x 2	redacted	£ -	£ -	£ -	£ -	redacted	redacted	+++	++	Regular service Improved connectivity Appeals to all consumers	LHR charges from 2022 Long term slot accrual issues at LHR LGW inbound LHR based
	London	LGW x 2 LCY x 2	redacted	£ -	£ -	£ -	£ -	redacted	redacted	++	++	Regular service Some improved connectivity Appeals to all consumers	LGW inbound LCY based
Removal of IOM APD (£13)		£-	£ -	redacted	redacted	redacted	redacted	redacted	-	+	Limited impact	Required services not safeguarded	
Removal of IOM APD (£6.5)		£-	£ -	redacted	redacted	redacted	redacted	redacted	-	+			
Establishment of a Manx Airline		High	£ -	£ -	£ -	£-	£-	High	+++	+		Most expensive option	

Source: Steer analysis and assumptions

Provision of financial assistance

Ensuring the longevity of services

Commercial Incentives

- 4.36 Passenger charges at the Isle of Man are currently high by industry standards (£25 per departing passenger), however most airlines operating are understood to receive a substantial discount on this charge. If this is the case, it provides little manoeuvrability to further discount charges to incumbent carriers to assist with traffic preservation/development.
- 4.37 The passenger charges can however be used to deter anti-competitive behaviour, with full charge levels being proposed to any operator planning to commence additional services on routes where this would create a risk of overcapacity, or where severe leakage of traffic from other routes is envisaged.
- 4.38 If necessary, the current passenger charges could be raised, whilst maintaining discounts to agreed levels. This would further deter carriers from adding capacity where it is deemed to be unsustainable.
- 4.39 If not already in position, an airport Aviation Development Director should be installed with the ability to explore commercial discussions and to set long-term arrangements (5-years) to benefit the Isle of Man and to ensure a sustainable, frequent, reliable, and valuable service is offered.

PSO

- 4.40 The designation of routes as PSO to maintain their operation is possible, however the other options to support service preservation/development should first be explored. As the routes in question have all been operated commercially and all currently have incumbent carriers, further consideration will need be given to how these agreements could be adopted considering competition law.
- 4.41 If the desired service outcome cannot be achieved with a commercial agreement (airport charges and marketing), designation of routes as PSO could permit additional funding to be made available/provide more certainty to carriers.

Next steps

- 4.42 As a first step commercial discussions should occur to determine what is possible without the implementation of route licences or a PSO. This can take the form of:
- Further discounts to airport charges, where possible;
 - The provision of marketing support to airlines; and
 - Using current charge levels/increased charged levels to prevent predatory behaviour where a market is being operated at capacity or where the additional capacity introduced would create overcapacity.
- 4.43 If not already in position, an Aviation Development Director should be installed with the ability to explore commercial discussions and to set long term arrangements to benefit the Isle of Man and to ensure a sustainable, frequent, reliable, and valuable service is offered.
- 4.44 If it is determined that commercial measures alone are not sufficient to safeguard services, the regulation of core routes with route licencing should be investigated to provide a further level of protection to incumbent operators.

- 4.45 If it is determined that commercial measures and route licencing are not sufficient to guarantee the economic viability of a route, the designation of routes as PSO should be investigated.
- 4.46 Immediately focus is required on the Manchester route to prevent overcapacity and to ensure to continued operation of the route with multiple daily frequencies and onward connectivity.

Conclusion

- 4.47 Having considered the size of the markets and their importance to the Island, the needs of the business and leisure markets and the various policy options, the preferred solutions for the various markets may vary, given the different dynamics and current competitor situations that exist in the various markets. However, the table below provides a summary of some of the preferred solutions that could support the required development of services in each of these four core markets.

Table 4.6: Summary of potential options for route development on core routes

Destination Market	Required change to network offering	Additional financial support required	Regulatory regime applied	Net Cost (£m) ¹⁹
Liverpool	None.	None.	Open Skies. Route operates sustainably with two carriers (provided PTC contract is maintained). Should the status-quo change and there is a risk of external predatory behaviour then route licences for incumbent airlines should be considered.	<i>Information redacted</i>
Manchester	Choice between high frequency regional service, enhancing connectivity or low-frequency option with mainline aircraft. Market unlikely to sustain both.	Only through airport charges. Possible opportunity to extend the scope of the PTC contract to include services to MAN for operator to provide multiple daily services	Open Skies, but if financial incentives/disincentives are not enough to influence optimal network, then consider the application of a route licence ²⁰ .	<i>Information redacted</i>
London	Additional capacity and frequency of services required. Ideally additional airport destinations (LCY/LHR) required.	Yes – additional financial support likely.	Application of route licencing for LGW, LCY and LHR, providing protection for incumbent and/or new carrier to operate	<i>Information redacted</i>

¹⁹ These are the net costs associated with sustaining a service that will break-even and associated costs can be covered though commercial incentivisation or with a PSO agreement. Liverpool (with PTC), Manchester and Dublin have historically operated profitably without direct financial support.

²⁰ A route licence should only be issued when the preferred carrier is operating the route solely. Currently this is not possible as two carriers are operating on the route.

Destination Market	Required change to network offering	Additional financial support required	Regulatory regime applied	Net Cost (£m) ¹⁹
			without fear of additional competition on the route.	
Dublin	New service required. Likely awaiting Emerald Air (Aer Lingus) to grow after its accelerated start-up.	Only through application of lower airport charges to secure the reintroduction of a new service, combined with start up support	Open Skies. Route likely to return when market demand returns, likely operated by just one carrier.	Information redacted

Source: Steer analysis

Appendices

A Detailed analysis on core routes

Methodology

Schedules

- A.1 OAG Schedules analyser has been used to determine schedule variability and where aircraft were stationed to operate the route.

Fares and profitability

- A.2 Fares data has been compiled from OAG traffic analyser and from the Isle of Man Government to assess variability in fares.

- OAG traffic analyser compiles fares data from the MIDT database, which collates fares sold by travel agencies. This provides a weighted average fare paid by consumers. Additional OAG traffic compiles 'online' fares data by means of fare scraping for low-cost carrier airlines.
- The Isle of Man Government conduct a monthly fare scraping exercise on fares for all routes from the Isle of Man at 6-month, 3-month, 6-week, and 1-week advanced booking horizons). For routes which are operated multiple times daily it has been assumed that the cheapest flight has been presented. The average consumer booking horizon for the Isle of Man is unknown.

- A.3 Estimates for route profitability for carriers on core routes have also been calculated for 2018 and 2019 based on:

- Average fares compiled in the study, together with assumed ancillary revenues;
- Fuel costs by aircraft type and route length;
- Airport charges dependent on passenger flows and aircraft type from the IATA Airport Charges Database with an allowance for charge discounting based on industry knowledge;
- Estimates for other operating costs (staff, aircraft, maintenance, navigation) have been determined from airline annual reports and applied per available seat km (ASK); and
- Airport charge data was not received. Based on discussions with stakeholders it was estimated that carriers with substantial operations from the Isle of Man were able to access an 80% discount on published charges.

Operational performance

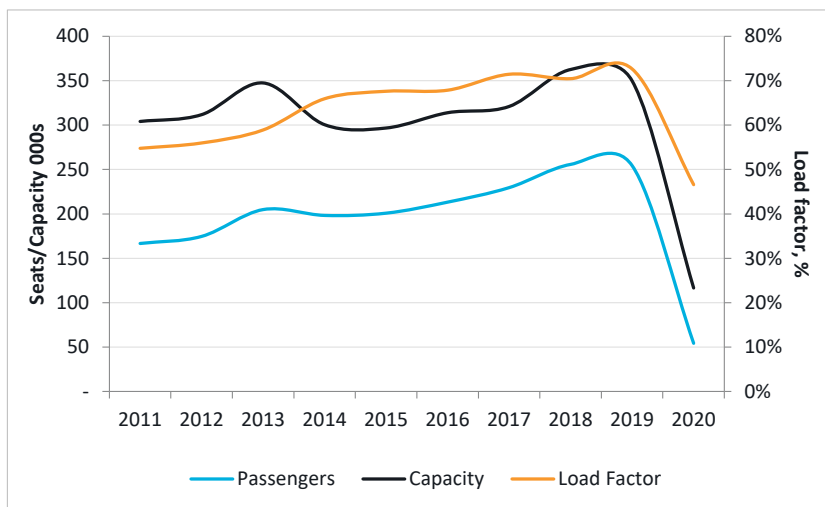
- A.4 Operational performance data has been obtained from the CAA and processed to present operational performance on routes to/from the Isle of Man as well as for comparator markets. This data has been analysed in the context of information available from the schedules analysis together with any other known operational issues. For routes to/from Liverpool and Southampton, this data is available from 2015 only.

Liverpool

Overview

A.5 Liverpool has consistently been the largest market to/from the Isle of Man with 31% of passengers travelling to/from Liverpool in 2019. Liverpool’s market share has grown year-on-year since 2011 when it was 22%. Between 2011 and 2019 passengers grew from 167,000 to 254,000 (CAGR+7.3%), driven in part by easyJet’s entry to the market in 2010. Average load factors have improved over the period from 55% in 2011 to 73% in 2019, partly due to capacity cuts. The figure below presents an overview of the development of the Liverpool market.

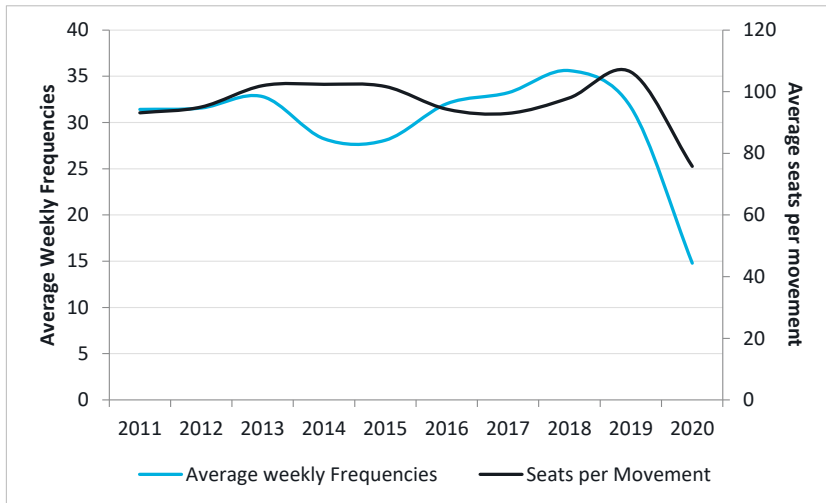
Figure A.1: Liverpool - Passengers, seats, and load factor – 2011-2020



Source: CAA, OAG, Steer analysis

- A.6 Two carriers, Flybe and easyJet, coexisted on the Liverpool route between 2010 and the bankruptcy of Flybe in March 2020. Loganair have since commenced services between Liverpool and the Isle of Man, maintaining competition and to provide the Patient Transfer Contract (PTC).
- A.7 Weekly frequencies have fluctuated between 28 and 35 flights weekly (one-way) over the period, whilst seats per movement have remained more constant, ranging between 93 and 106. This is shown in the figure below.

Figure A.2: Liverpool – Frequencies and seats per movement – 2011-2020



Source: OAG, Steer analysis

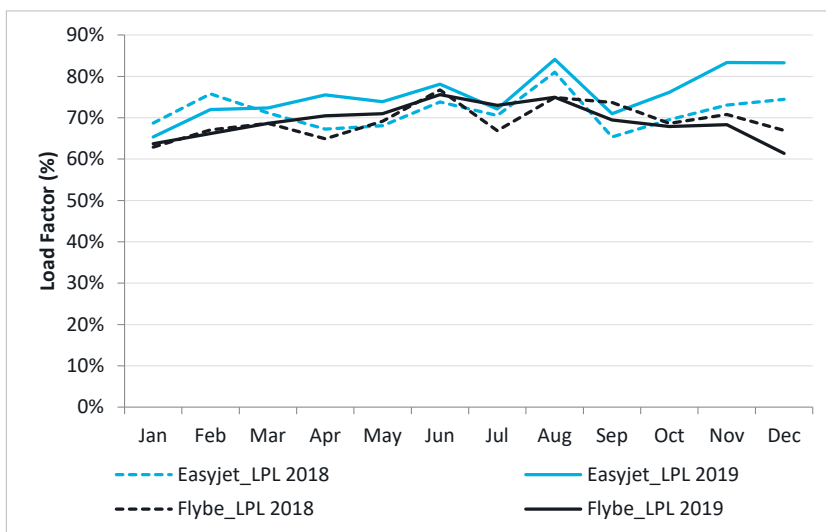
Schedules

- A.8 Despite the closure of Flybe’s base on the Isle of Man in 2014, Flybe continued to overnight an aircraft on the Island to operate flights to Liverpool. This aircraft will have been supplied and crewed from another base, with crews overnighting on the Island. When Flybe’s routes were transferred to the Stobart Air franchise, 2 aircraft were based and crewed from the Island until 2019 when Flybe brought the Isle of Man base in-house. Flybe planned to transfer the base back to Stobart Air in March 2020, however their bankruptcy prevented this from occurring.
- A.9 easyJet operate all schedules to the Isle of Man with inbound aircraft crewed and operated from their Liverpool base. No easyJet flights were found to overnight at Ronaldsway.

Fares and profitability

- A.10 The figure below shows that load factors for both easyJet and Flybe were broadly consistent and that there was no significant variation in load factor across the year.

Figure A.3: Liverpool – Monthly load factors – 2018-2019



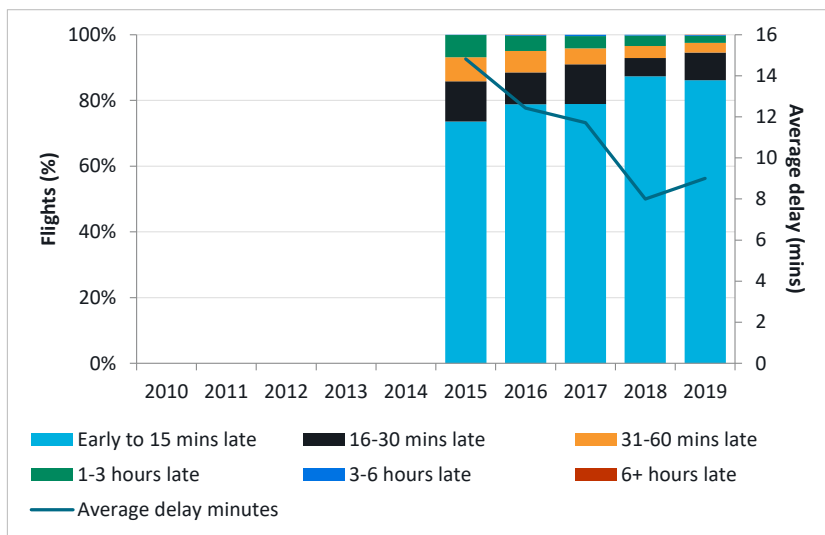
Source: IOM Government, OAG, Steer analysis

- A.11 **Information redacted**
- A.12 **Information redacted**
- A.13 **Information redacted**
- A.14 **Information redacted**
- A.15 **Information redacted**

Operational performance

A.16 The figure below presents Flybe’s operational performance on the Liverpool route. Data regarding operational performance of routes to/from Liverpool is only available from 2015. Prior to this it was not published by the CAA. Punctuality on the route improved from 2015, possibly resulting from the transfer in operation of the route from Flybe to Stobart Air, which had an operating base in the Isle of Man but also due to the need to compete with easyJet, which was operating the route more punctually.

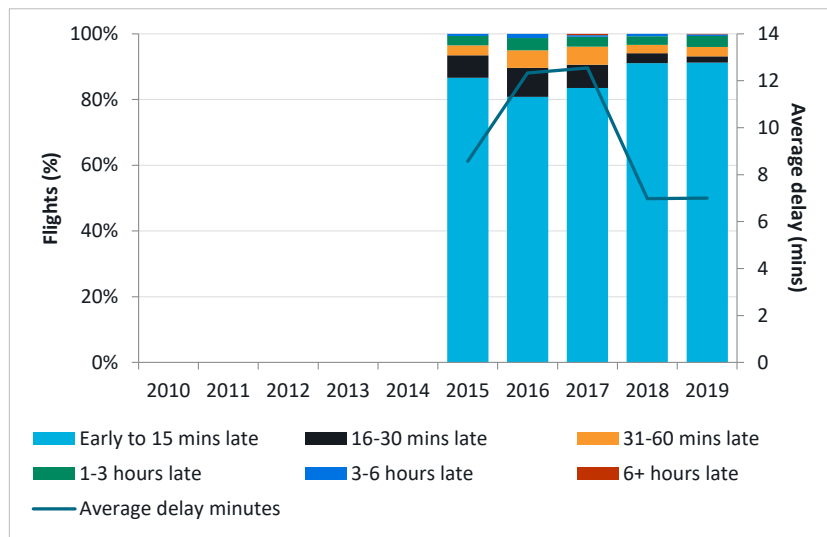
Figure A.4: Liverpool – Operating performance – 2015-2019 (Flybe)



Source: CAA, Steer analysis

A.17 The figure below presents easyJet’s operating performance on the Isle of Man to Liverpool route. The route has consistently been operated on-time for over 80% of flights, with punctuality dipping slightly in 2016 and 2017. This improved considerably in 2018/2019 and on-time performance was recorded for over 90% of flights. Flights were delayed on average by 7 minutes.

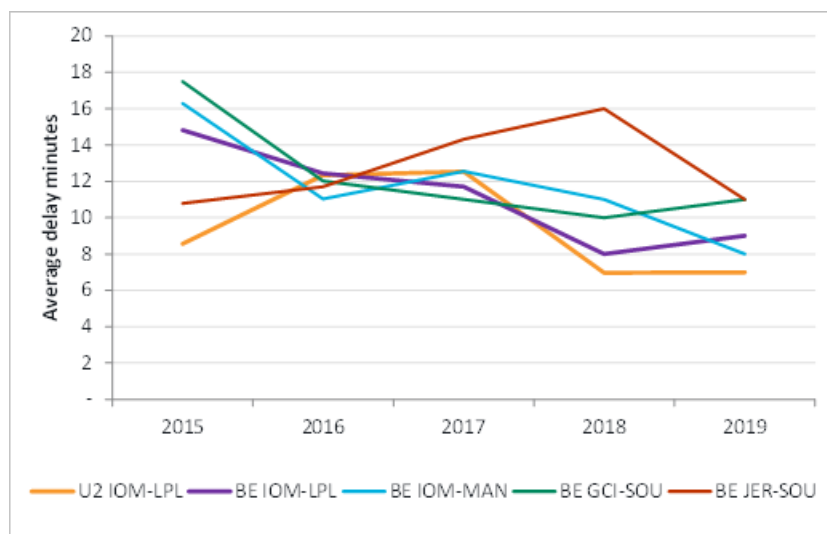
Figure A.5: Liverpool – Operating performance – 2015-2019 (easyJet)



Source: CAA, Steer analysis

A.18 The figure below shows a comparison of Flybe and easyJet’s operating performance with other peer markets (Isle of Man – Manchester, Jersey-Southampton, Guernsey-Southampton) in terms of average delay minutes. In 2016, delay minutes across all routes were comparable, however route performance to the Isle of Man has subsequently improved at a faster rate than in peer markets.

Figure A.6: Liverpool – Operating performance -Comparison with peer markets



Source: CAA, Steer analysis (U2-easyJet, BE-Flybe)

A.19 The full set of operating statistics for the peer routes can be found in Appendix B.

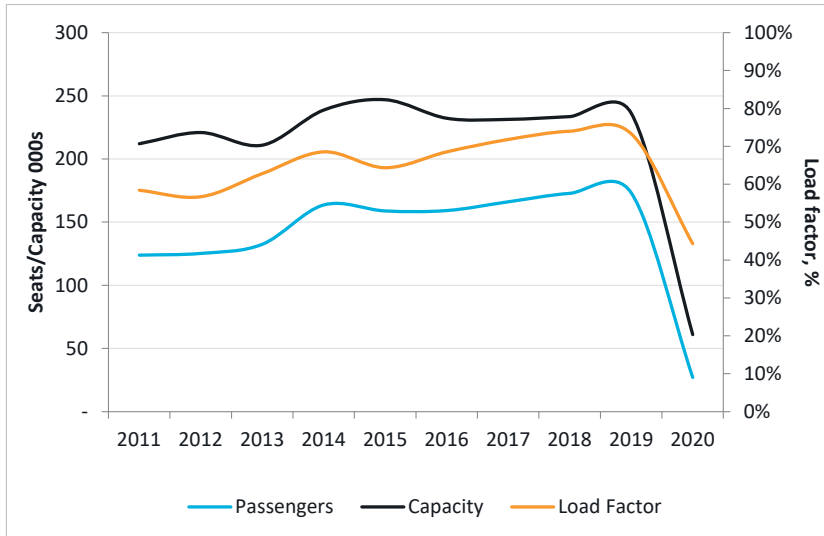
Manchester

Overview

A.20 The proportion of passengers travelling to Manchester has remained relatively constant at around 19-21% of passengers. 2014 was an exception where this increased to 24%, likely as a response to Flybe’s withdrawal from the London Gatwick route, and onward connectivity

instead being provided at Manchester. Between 2011 and 2019 passengers grew from 124,000 to 173,000 (CAGR+3.6%). Average load factors have improved over the period from 58% in 2011 to 73% in 2019. The figure below presents an overview of the Manchester market.

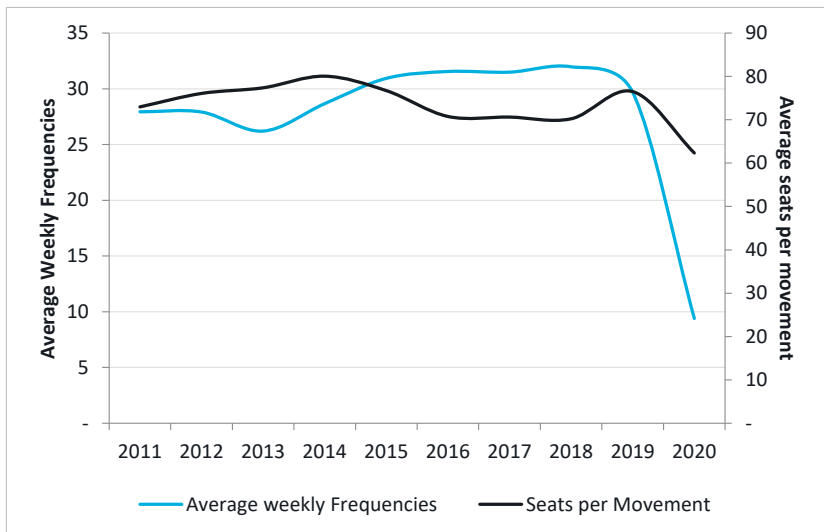
Figure A.7: Manchester - Passengers, seats and load factor – 2011-2020



Source: CAA, OAG, Steer analysis

- A.21 Flybe was the only carrier operating the route until its bankruptcy in March 2020. Loganair commenced services in 2020 and commenced services on this route for the Winter 2021 season (November 2021).
- A.22 The figure below presents weekly movement and average aircraft size. Weekly frequencies between 2011 and 2019 fluctuated between 26 and 32 flights weekly (one-way) over the period; an increase in services in 2014 can be seen after Flybe’s withdrawal from the London Gatwick route. Seats per movement have varied depending on the operating carrier. When Flybe operated flight in their own right, seat capacity per movement averaged around 78 per movement, but this reduced between 2016 and 2018 when Flybe flights were operated by Stobart Air.

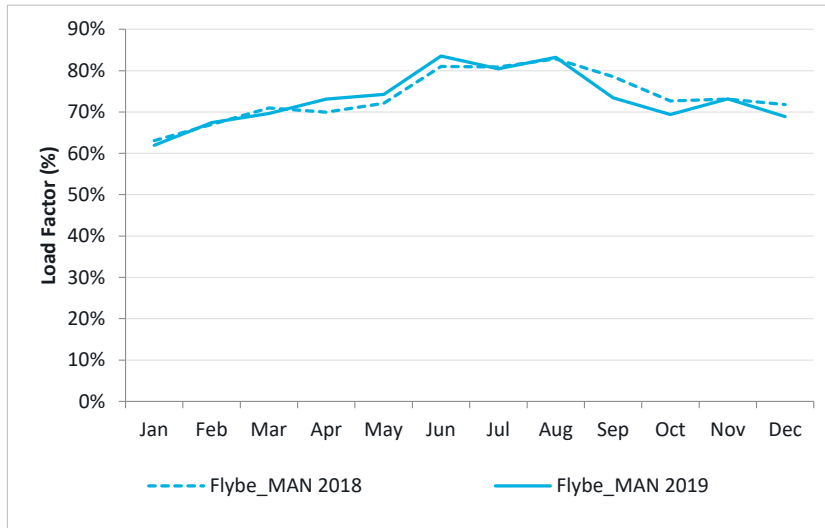
Figure A.8: Manchester – Frequencies and seats per movement – 2011-2020



Source: OAG, Steer analysis

- A.23 The figure below shows monthly load factors on the Manchester route in 2018 and 2019. Average load factors peak in the summer months at around 80%, falling to 63% in January. The profile across both of the years analysed is consistent.

Figure A.9: Manchester – Monthly load factors – 2018-2019



Source: IOM Government, OAG, Steer analysis

Schedules

- A.24 Analysis of aircraft schedules shows that the Manchester route was operated by an overnighiting aircraft after Flybe closed its base in 2014. This would be have been supplied and crewed from another base. This route transferred to Stobart Air from 2016 and was operated with a based aircraft.

Fares and profitability

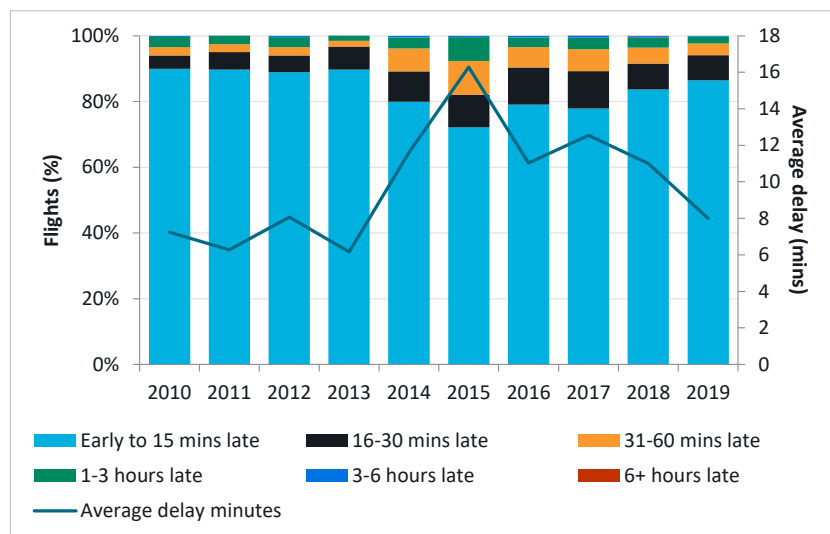
A.25 **Information redacted**

A.26 **Information redacted**

Operational performance

- A.27 The figure below shows Flybe’s operational performance on the Manchester route. Punctuality worsened between 2013 and 2015, with only 70% of flights arriving on-time. Punctuality improved between 2016 and 2019.

Figure A.10: Manchester – Operating performance – 2015-2019 (Flybe)



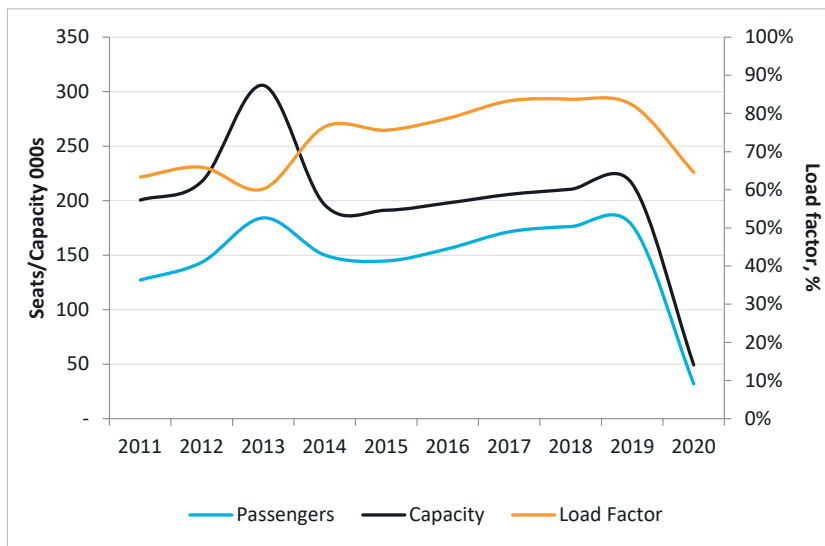
Source: CAA, Steer analysis

London

Overview

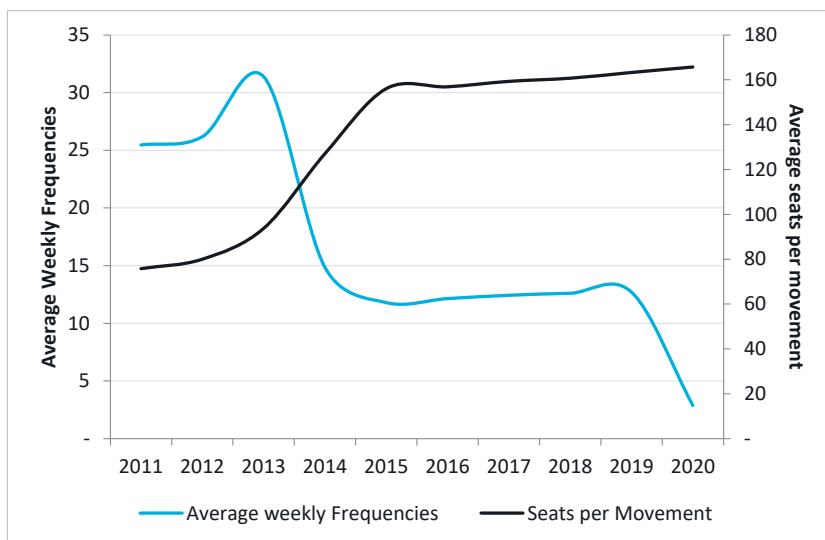
- A.28 32% of passengers travelling from the Isle of Man in 2019 were travelling to London airports, with London Gatwick being the primary gateway (21%) and London City secondary (7%). In 2019, the Isle of Man also had direct flight to London Luton (3%) and London Heathrow (2%) in the summer season. In 2019, Flybe operated a daily flight between the Isle of Man and London Heathrow for the summer season only. This route utilised a slot leased to Flybe by then parent company Virgin/Delta and was cancelled (together with Guernsey) at the end of the season.
- A.29 The London Gatwick and London City markets have been analysed in detail below.
- A.30 The figures below present an overview of the **London Gatwick** route. Between 2011 and 2019 passengers grew from 127,000 to 177,000 (CAGR+4.2%). In 2011, Flybe was the only operator on the route, and operated 3-4 daily frequencies. easyJet entered the London Gatwick market in 2013, which significantly increased capacity on the route and passenger levels increased to 184,000. In 2014, Flybe closed its base at London Gatwick, citing increased airport charges and easyJet became the sole operator on the route. In 2015, passenger numbers returned to levels seen in 2012, but with significantly reduced frequencies (1-2 flights per day) and slightly reduced capacity offset by an increase in average load factor. Passengers and capacity have since grown gradually, however frequencies remain considerably lower than pre-2013.

Figure A.11: London Gatwick - Passengers, seats and load factor – 2011-2020



Source: CAA, OAG, Steer analysis

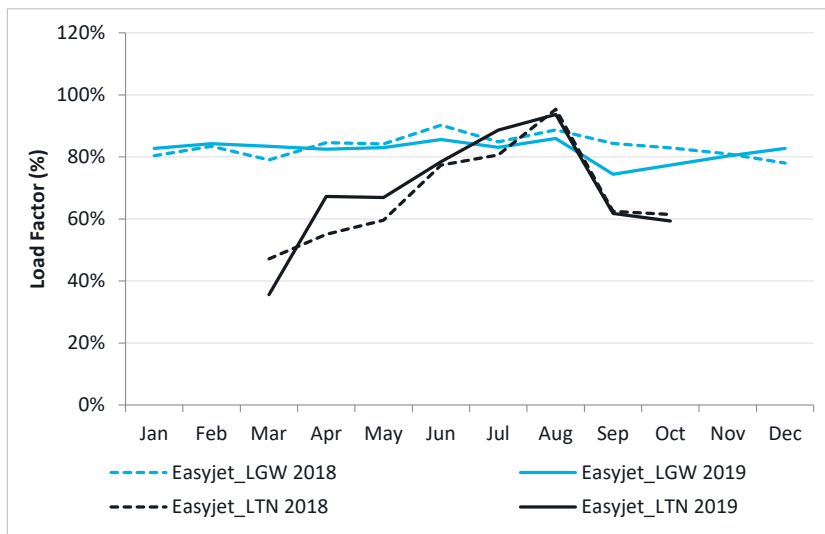
Figure A.12: London Gatwick – Frequencies and seats per movement – 2011-2020



Source: OAG, Steer analysis

A.31 The figure below shows the seasonal variation in load factor on the London Gatwick and London Luton routes in 2018 and 2019. In both years the average load factor on the London Gatwick route remains above 80% for the majority of the year, whilst the load factor on the Luton route reaches similar levels in the peak-summer months only. The London Luton route is operated in the summer season only.

Figure A.13: London Gatwick – Load factors – 2018-2019

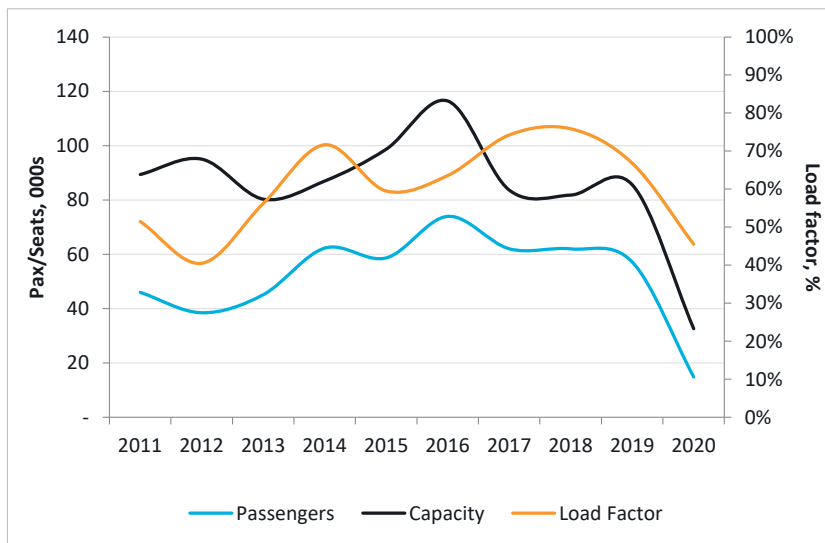


Source: IOM Government, OAG, Steer analysis

- A.32 The figures below present an overview of the **London City** route. Between 2011 and 2019 passengers grew from 46,000 to 57,000 (CAGR+1.0%). In 2012, Aer Arran cancelled the route and it was taken over by British Airways subsidiary BA Cityflyer.
- A.33 Aer Arran operated the route 2-3 times daily, however reduced to 1 x daily from September 2013 under BA Cityflyer²¹. From the start of the Summer 2014 Season the service was increased to 3 x daily due to financial backing from of e-gaming firm ‘Microgaming’, however this arrangement was cancelled in 2017 and services reduced to an average of 2x daily.
- A.34 The majority of BA Cityflyer’s flights were contracted out to Eastern Airways from 2012 to 2018, after which Loganair flew on behalf of BA Cityflyer. BA Cityflyer cancelled the route in March 2020 and Loganair resumed operation of the route under its own brand. Due to the closure of London City Airport between March and June 2020, Loganair switched operations to London Heathrow, however cancelled the route in August 2021 after the Government subsidy provided for the route was removed. Current no carrier operates to London City Airport.

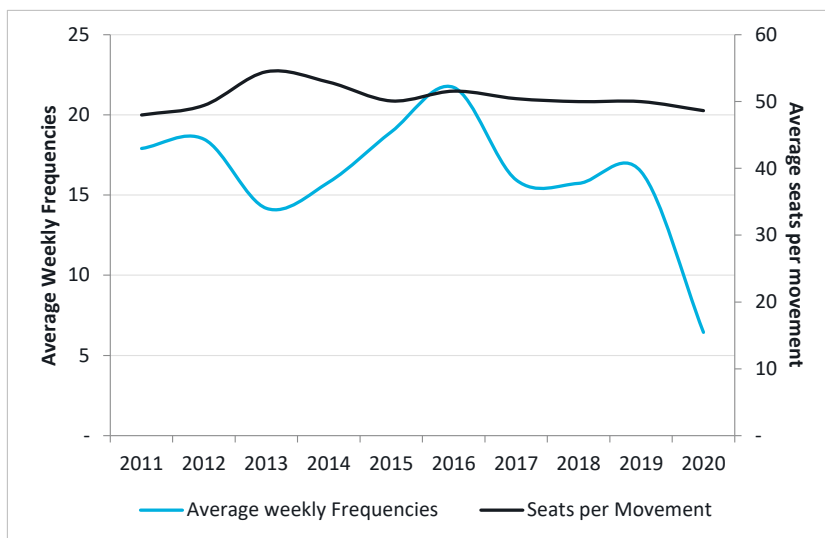
²¹ <https://www.routesonline.com/news/38/airlineroute/206589/ba-cityflyer-reduces-london-city-isle-of-man-service-from-sep-2013/>

Figure A.14: London City - Passengers, seats and load factor – 2011-2020



Source: CAA, OAG, Steer analysis

Figure A.15: London City – Frequencies and seats per movement – 2011-2020



Source: OAG, Steer analysis

Schedules

- A.35 Prior to the base closure, Flybe based three Dash 8-400 aircraft (78 seats) on the Isle of Man, one of which conducted an early rotation to London Gatwick, departing around 06:45 and arriving in London at 08:20. This early morning departure was removed when the base closed. Flybe briefly operated flights to London Stansted, however these were operated in a ‘W’ pattern from their Manchester base.
- A.36 easyJet operates its London routes on an ‘inbound’ basis from its London bases and no aircraft were found to overnight on the Isle of Man. The table below summaries the 2019 departure schedule from the Isle of Man to Gatwick. On some days there was a morning rotation to Gatwick, however the 09:50-10:00 departure did not provide an arrival into London until after 11am. The evening rotation was more consistent operating most weekdays and Sundays,

however it did not arrive at London Gatwick until after 10pm, not allowing for any connections without an overnight stay. Mid-day frequencies were primarily provided at weekends.

Table A.1: easyJet departure times to London Gatwick (2019)

	Departure (IOM)	Arrival (LGW)	Frequencies
Morning	09:50-10:00	11:00-11:15	218
Mid-day	13:45-16:55	15:05-18:10	109
Evening	19:55-21:05	21:05-22:20	330

Source: OAG, Steer analysis

- A.37 BA Cityflyer based one Saab 2000 aircraft (50 seats) at the Isle of Man, permitting an early morning departure to London City on weekdays, with an arrival prior to 08:30. An evening departure rotation (with subsequent return from London City) was provided on virtually all weekdays, providing a good schedule for a day return trip to London.

Table A.2: BA Cityflyer departure times to London City (2019)

Rotation	Departure (IOM)	Arrival (LCY)	Frequencies
Morning	06:45-07:00	08:20-08:25	259
Mid-day	09:55-14:15	11:20-15:40	313
Evening	16:35-18:05	18:10-19:30	284

Source: OAG, Steer analysis

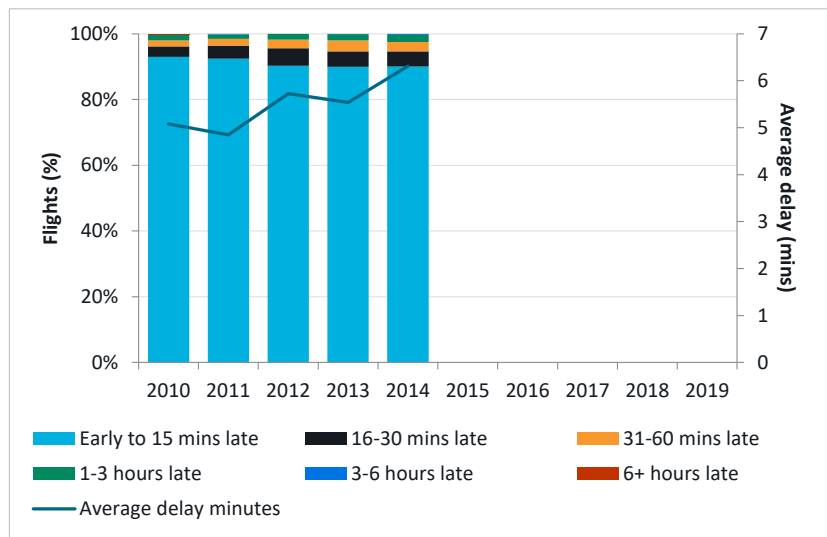
Fares and profitability

- A.38 **Information redacted**
- A.39 **Information redacted**
- A.40 **Information redacted**
- A.41 **Information redacted**
- A.42 **Information redacted**
- A.43 **Information redacted**

Operational performance

- A.44 On time performance between Flybe (2010-2014) and easyJet (2012-present) have been compared. The figure below shows that between 2010 and 2014 around 90% of Flybe flights to London Gatwick either arrived early or within 15 minutes of their scheduled arrival time. The majority of the remainder of the delays were of less than one hour. The average delay time on the route increased from five to seven minutes between 2010 and 2014, although this is likely a function of Gatwick Airport increasingly approaching operating capacity during this period.

Figure A.16: London Gatwick (Arr) – Operating performance – 2010-2014 (Flybe)

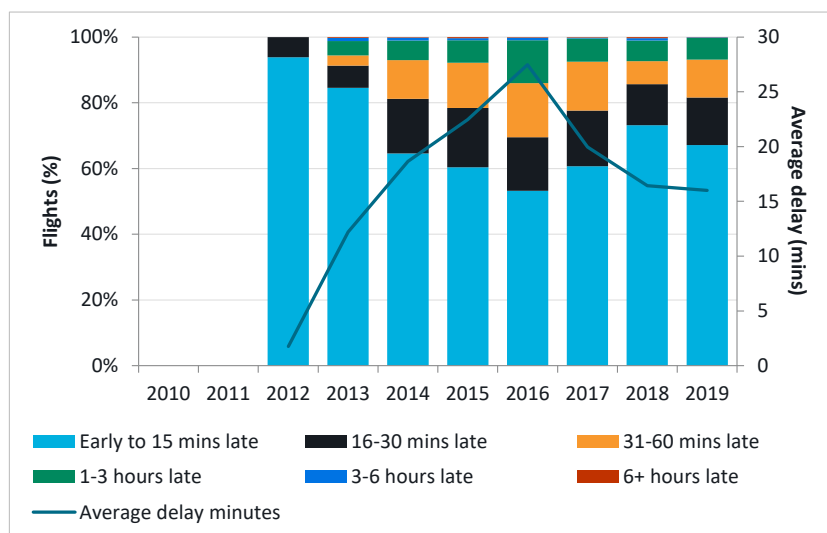


Source: CAA, Steer analysis

A.45 The figure below shows easyJet’s operating performance on the route between 2012 and 2019. Operating performance was initially very good, with over 90% of flights arriving at London Gatwick on-time. This performance deteriorated considerably between 2012 and 2016, with only 53% of flights arriving on-time in 2016 and an average delay of 27 minutes. Punctuality has since improved and the average delay reduced to 15 minutes in 2019, however 33% of flights still arrived over 15 minutes late. This will have been a function of:

- Capacity constraints at London Gatwick reducing redundancy in the event of disruption;
- easyJet scheduling multiple rotations per day for aircraft across its network and delays accumulating throughout the day; and
- easyJet not basing aircraft in the Isle of Man.

Figure A.17: London Gatwick (Arr) – Operating performance – 2012-2019 (easyJet)

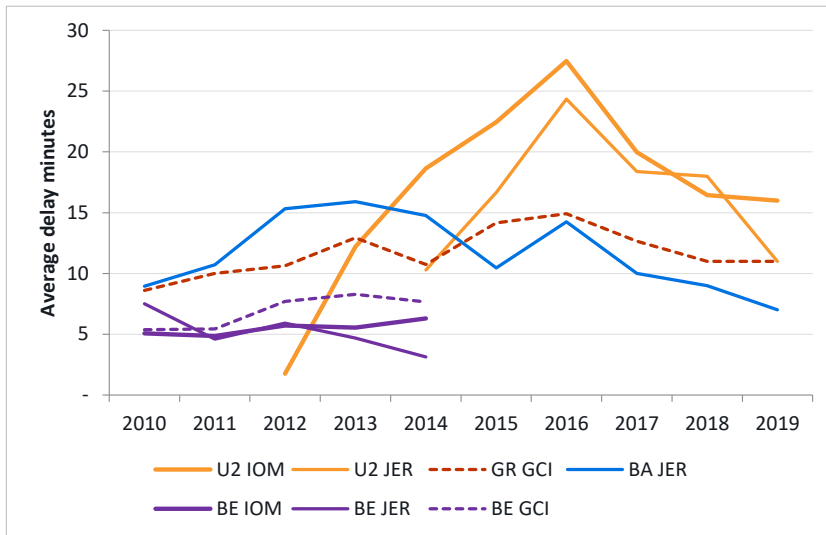


Source: CAA, Steer analysis

A.46 The figure below compares operational performance on the London Gatwick route with peer markets (Jersey and Guernsey). easyJet’s operational performance on its Isle of Man and

Jersey routes is comparable, with both featuring deteriorating performance until 2016 and subsequent improvements. The performance of British Airways (Jersey) and Aurigny (Guernsey) are broadly comparable with an average delay of 10-15 minutes. The performance of these airlines in 2016 compared with easyJet shows that easyJet’s delays were likely due to internal operational issues. Prior to its exit from London Gatwick, operational performance of Flybe’s routes was considerably better than the other airlines investigated, with an average delay of approximately five minutes. Performance of the Isle of Man route is between the performance of the Guernsey and Jersey routes.

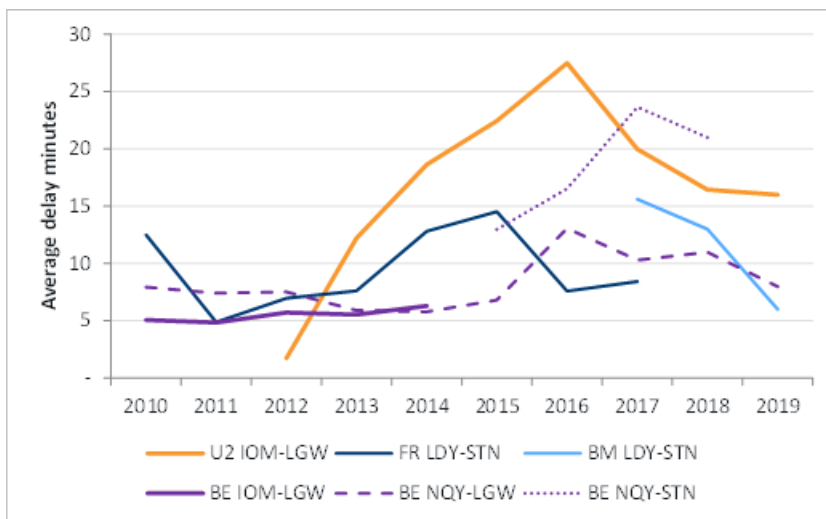
Figure A.18: London Gatwick – Operating performance -Comparison with peer markets (Channel Islands)



Source: CAA, Steer analysis

A.47 Further comparisons can be seen in the figure below, which compares operational performance on flights to London from the Isle of Man with flights to London from Derry-Londonderry and Newquay. The performance of Flybe from the Isle of Man is fairly comparable with other carriers to London, including Ryanair, bmi regional and on its own route from Newquay to London Gatwick; delays averaging no more than 15 mins late. However, the poor performance of easyJet from 2013 onwards only further confirms issues must have originated internally to cause such high average delays.

Figure A.19: London Airports – Operating performance -Comparison with peer markets (PSO)



Source: CAA, Steer analysis

B Peer markets

Summary

		Isle of Man	Jersey	Guernsey	Newquay	Derry	Dundee	Teesside	Bornholm
Population (2019)		84,500	105,500	63,000					39,500
GDP per capita (2019)		89,100 USD	£45,300	£52,500					40,900 USD
Annual passengers (2019)		855,000	1,728,000	855,000	461,469	203,272	22,024	148,000	228,000
Passenger growth (2014-2019)		+3.2%	+2.9%	+0.9%	+15.9%	-10.3%	+0.0%	+0.8%	-0.3%
Passengers per population		10.1	16.7	14.0					5.8
Based carriers		-	Blue Islands ²²	Aurigny	-	-	-	-	-
Overnighting carriers		Flybe	British Airways	-	Flybe	Loganair	Loganair	Loganair	DAT
Primary market		Liverpool	London LGW	London LGW	London LHR ²³	Edinburgh	London STN	Amsterdam	Copenhagen
London market	LHR	Flybe (S19)	-	Flybe (S19)	Flybe - PSO	-	-	Loganair	
	LGW	easyJet	British Airways easyJet	Aurigny	-	-	-	-	
	LCY	BA Cityflyer	Blue Islands	-	-	-	-	-	
	STN	-	-	Aurigny	-	Loganair - PSO	Loganair - PSO	-	
	LTN	easyJet (S)	-	-	-	-	-	-	
Other large markets		Manchester	Southampton	Southampton	-	Liverpool		Aberdeen	
Route authority		Open Skies	Open Skies	Quasi-Open Skies	Open Skies	Open Skies	Open Skies	Open Skies	
Routes (>10,000 seats)		10	18	11	10	4	1	2	
Average aircraft seat size		91	99	68	75	87	33	59	

²² Blue Island operated as a Flybe franchise in 2019

²³ Flybe operated a 3x daily service to London Gatwick until March 2019 when this was moved to London Heathrow

Jersey

Overview

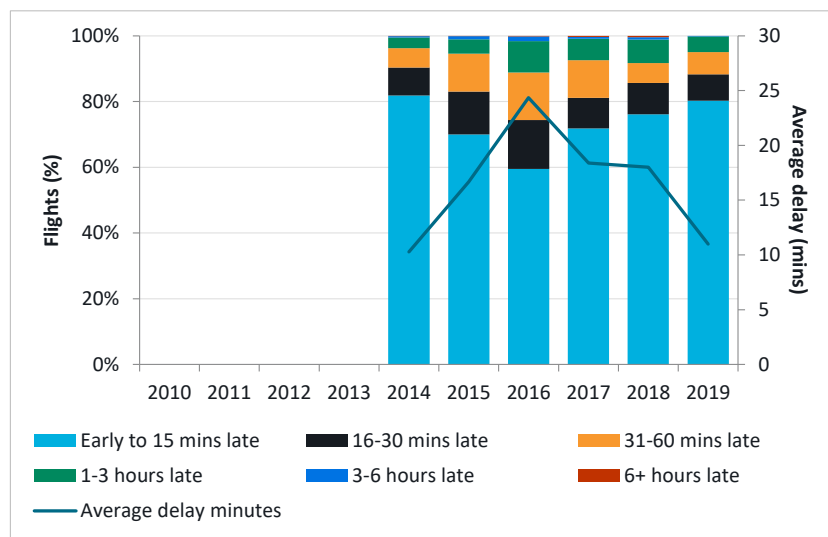
- B.1 Jersey introduced an Open Skies policy in 2003 after maintaining route permits since the introduction of EU Open Skies in 1993. Jersey is home to privately owned airline ‘Blue Islands’ and the Island was also a base for Flybe until 2014. London Gatwick is the largest air route from Jersey, accounting for over 40% of passengers. Prior to 2014, British Airways and Flybe competed on the route, however Flybe withdrew from the route in 2014 after closing its London Gatwick operation. EasyJet purchased Flybe’s Gatwick slots and commences services to London Gatwick at the same time, maintaining competition on the London route.
- B.2 In 2019 British Airways overnighted an aircraft at Jersey to typically provide a departure around 7:00am to London Gatwick (arriving 8:00am). easyJet flew to Jersey on an inbound basis and consequently its first departure from Jersey was typically at around 8:30am (arriving 9:30am).

Blue Islands

- B.3 Jersey is home to privately owned airline Blue Islands. Between 2016 and 2020, the airline operated as a Flybe franchise, however it has since resumed operations under its own brand. In July 2020, the airline announced it would take over a number of former Flybe routes after landing a loan of up to £10 million from the Government of Jersey. The airline had been operating “lifeline” flights from Jersey to Southampton and Gatwick during the COVID-19 pandemic²⁴.

Operating performance

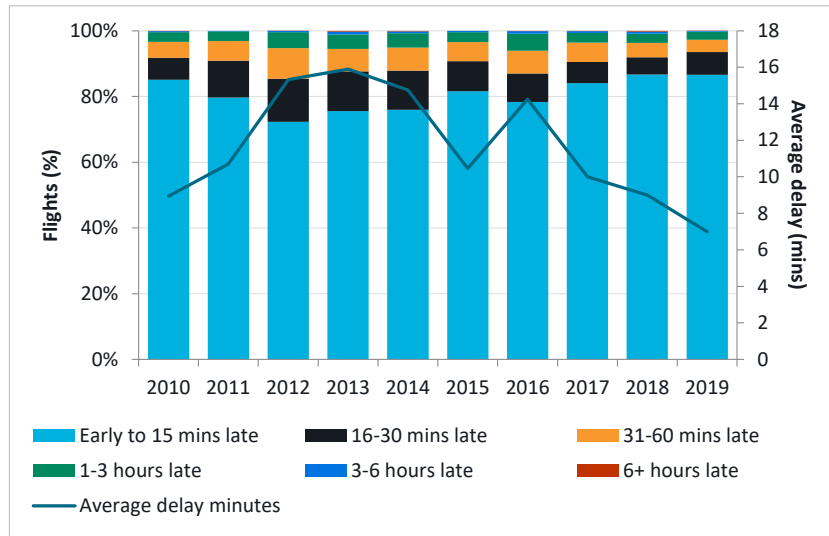
Figure B.1: London Gatwick – Jersey – Operating performance – 2012-2019 (easyJet)



Source: CAA, Steer analysis

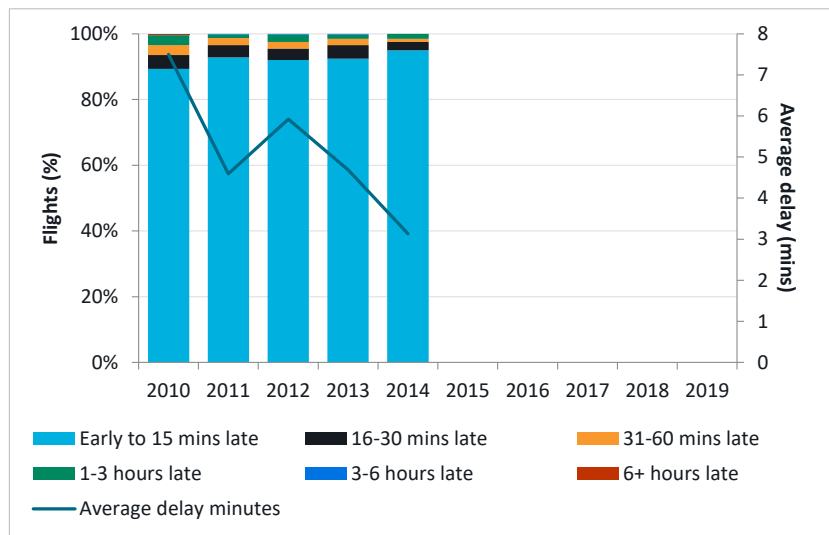
²⁴ <https://www.business-live.co.uk/economic-development/Blue-Islands-take-over-flybe-18567352>

Figure B.2: London Gatwick- Jersey – Operating performance – 2012-2019 (British Airways)



Source: CAA, Steer analysis

Figure B.3: London Gatwick- Jersey – Operating performance – 2010-2014 (Flybe)



Source: CAA, Steer analysis

Guernsey

Overview

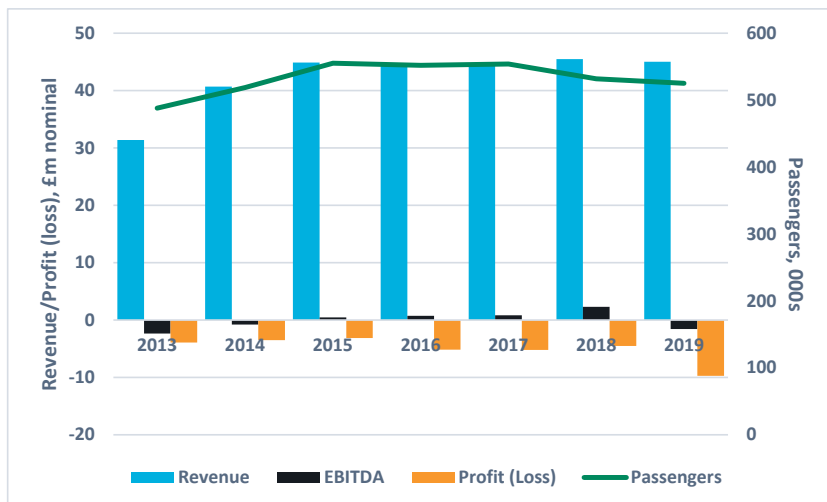
B.4 Guernsey introduced a Quasi-Open Skies policy in 2018 after maintaining route permits since the introduction of EU Open Skies in 1993. London Gatwick is the largest air route from Guernsey, accounting for over one third of passengers, whilst Southampton is the second largest with around 15%. The States of Guernsey own their own airline ‘Aurigny’ and the Island was also a base for Flybe until 2014.

Aurigny

B.5 The States of Guernsey own their own airline Aurigny to operate flights to/from the United Kingdom.

B.6 The figures below presents an overview of Aurigny’s operating statistics. In terms of EBITDA, Aurigny has incurred small losses since 2013. Aurigny attributed these losses to the introduction of Quasi-Open Skies on all routes except to London-Gatwick and route support available for Flybe and Blue Islands to start new routes to London-Heathrow, London-Southend and Liverpool. Due to the need to maintain the airline’s slots at London Gatwick, Aurigny was unable to reduce capacity on its London Gatwick route in response to the competition. In overall terms the airline has been loss-making since it was purchased by the States of Guernsey in 2003. Prior to COVID-19 £25m had been injected into the airline by the States, with the impact of COVID-19 increasing this amount by a further £75m²⁵.

Figure B.4: Aurigny operational statistics – 2013-2019



Source: Aurigny, Steer analysis

Quasi-Open Skies

B.7 Prior to 2018 air transport licences were required for services between Guernsey and UK, Isle of Man and the Channel Islands with route applications being determined by the Transport Licencing Authority. In 2017 a review was carried out by the Committee for Economic Development²⁶, which recommended that [quote]²⁷:

- routes should be designated into two types: lifeline (essential) and all other routes;
- all routes apart from lifeline routes will become exempt from licencing;
- operators and charterers on lifeline routes will still require licencing;
- where necessary, lifeline routes can be protected through the granting of Public Service Obligations ('PSOs') as used in the UK and throughout the EU – along with any required funding;
- funding support for the launch of new routes will be considered in accordance with the terms of the Committee’s policy statement on such funding.

²⁵ <https://www.bailiwickexpress.com/jsy/news/guernsey-bails-out-aurigny-brink-liquidation/#.YW5-JzhKhPY>

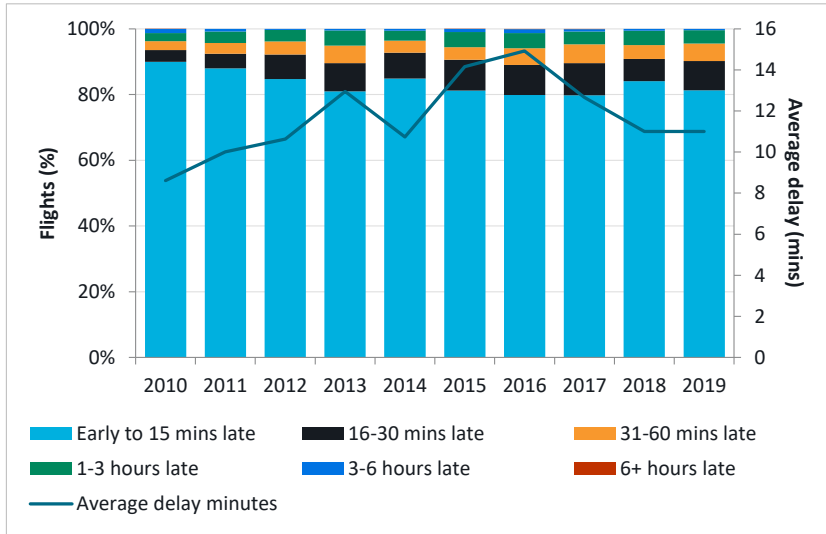
²⁶ Previously the Treasury and Resources Department

²⁷ <https://www.gov.gg/CHttpHandler.ashx?id=113644&p=0>

- B.8 Lifeline routes are those deemed essential for economic and/or social reasons and which would not be sustainable without some degree of government intervention and/or ongoing financial support. Two routes, London Gatwick and Alderney, were classified as lifeline routes. Where a lifeline route is not commercially viable given the minimum service levels and aircraft type expected by the community that it serves, the Committee has the ability to create a Public Service Obligation (PSO) for that route, supported with appropriate funding.
- B.9 64% of passengers on the London Gatwick route are Guernsey residents and it was deemed 'essential for Guernsey's economic prosperity, important for residents' social wellbeing and useful for healthcare needs'. Prior to 2014, Aurigny and Flybe competed on the route, however Flybe withdrew from the route in 2014 after closing its London Gatwick operation and also closed its Guernsey base. This left Aurigny as the sole operator on the route. Due to the runway length at Guernsey (1,463m), operations by easyJet would incur weight penalties and so the airline did not commence flights to Guernsey. Gatwick Airport is heavily slot constrained and Aurigny was unable to acquire more slots to make-up the shortfall in capacity after Flybe's withdrawal. A decision was made to purchase a 119 seat Embraer 195 aircraft to increase capacity. By maintaining Aurigny as the sole carrier on the route, there is little risk that slots currently allocated to Guernsey services will be allocated to other more profitable routes as would be the risk if this route was operated by a non-states owned carrier. The London Gatwick route was considered commercially viable as it is not a beneficiary of a PSO arrangement.
- B.10 By maintaining the air transport licencing policy, Aurigny has remained the sole operator on the route. A series of KPIs relating to seat capacity, service reliability and affordable services have been set to keep track of route performance. A review of this policy is expected to be conducted in 2023.
- B.11 The Alderney connection represents a social link for Alderney's residents and is substantially loss making for Aurigny. Due to the Island's population and service level requirements, there is no prospect for the service to become profitable and so a PSO arrangement has been applied.
- B.12 All other routes were deemed to add a level of additional choice and connectivity to residents and Open Skies was recommended to encourage new route development and innovation, whilst reducing the administrative burden for parties involved. Route classifications are reviewed every five years, or earlier if significant market changes require a review.
- B.13 Southampton is Guernsey's second most travelled route and also provides an important connection for non-urgent medical trips. Southampton was considered for inclusion in the lifeline category, however given the routes long year-round service history and availability of slots at Southampton it was decided not to designate it as a lifeline route.

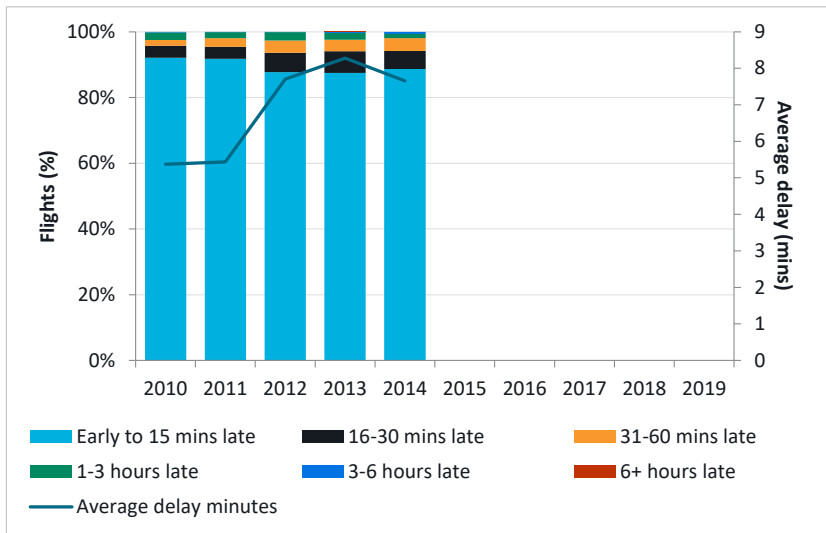
Operating performance

Figure B.4: London Gatwick- Guernsey – Operating performance – 2010-2019 (Aurigny)



Source: CAA, Steer analysis

Figure B.5: London Gatwick- Guernsey – Operating performance – 2010-2014 (Flybe)



Source: CAA, Steer analysis

Newquay

B.14 Prior to 2014 an Open Skies policy was applied to all routes to/from Newquay and two operators, Air Southwest and Flybe competed on the London Gatwick route until 2011, when Flybe was left as the sole operator. The route to Newquay was impacted by Flybe’s withdrawal from London Gatwick in 2014, and measures were taken to secure the longevity of the route with a PSO. A four-year funding deal with Flybe was announced in October 2014 with the government providing £2.5m and Cornwall council £300k. Three return Newquay-Gatwick trips per weekday (two on Saturday and Sunday) with 78 seat Dash-8 turboprop aircraft were agreed under the terms of the PSO with flights being operated at times to provide a ‘convenient schedule for a full working day at either destination’. 100,000 passengers per year

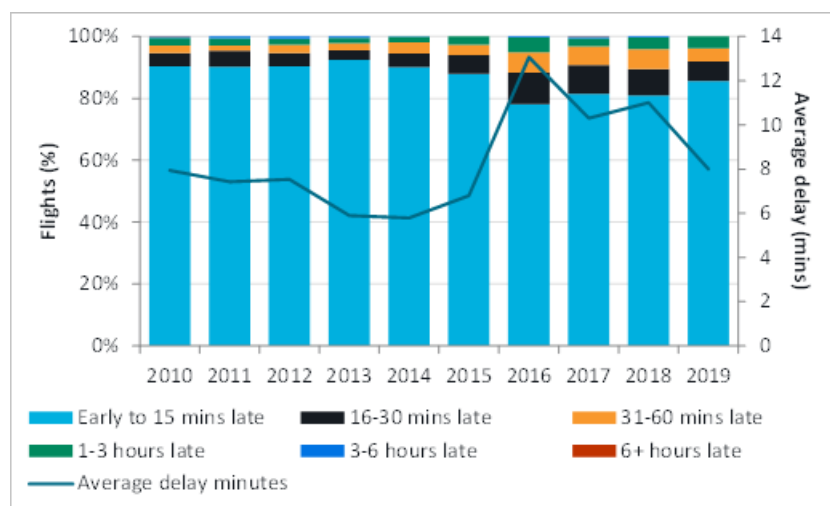
were expected to use the route and a return rate of £3 per £1 invested was cited²⁸. Passenger numbers increased from 2014 and from Summer 2016, larger 119 seat Embraer E195 jet aircraft were introduced on the route. In 2018, total compensation paid for the operation of the route in 2018 was €709,000 equating to €4 per passenger. Compensation was only paid if a reasonable profit was not made on the route. Compensation was paid by Cornwall Council.

B.15 From April 2019, flights were moved from London Gatwick to London Heathrow as Flybe were able to redesignate some of the slots they had accrued at Heathrow under the terms of the commitments made for the BA-bmi merger to other domestic routes, besides from the Edinburgh and Aberdeen routes they were operating. Flybe’s remaining Gatwick slots were sold to Vueling. Newquay lost its route to London when Flybe declared bankruptcy in March 2020.

B.16 British Airways reinstated the London Heathrow service from September 2020 for seven months with a PSO subsidy totalling £878,000 (equivalent to £4,000 per flight), however the most recent attempts to award a PSO contract for the route have been unsuccessful. easyJet and British Airways operated between London and Newquay in the Summer 2021 period, however neither carrier has operated scheduled services after September 2021.

Operating performance

Figure B.6: London Gatwick- Newquay – Operating performance – 2010-2019 (Flybe)



Source: CAA, Steer analysis

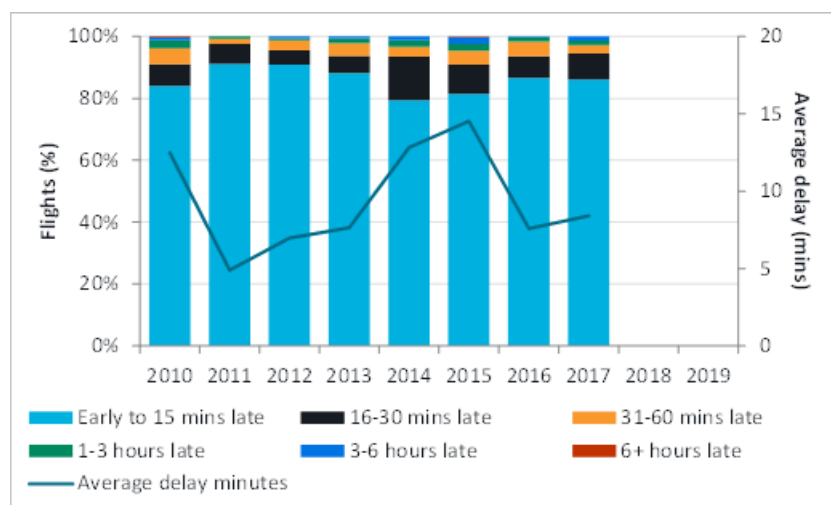
Derry/Londonderry

B.17 The Open Skies policy permitted Ryanair to fly routes from the Derry/Londonderry to destinations in the United Kingdom and wider European Union, which included a twice daily service to London Stansted until 2017, when the airline dropped the route. In response, the UK Government accepted a PSO proposal from the airport, initially providing £3.8 million of funding to support a route from Derry/Londonderry to London Stansted for two years. The contract was fulfilled by bmi regional, providing 13 return weekly frequencies (67,600 annual seats) at a cost of £28 per seat. This was the first form of government backing for a PSO to Northern Ireland.

²⁸ <https://www.gov.uk/government/news/government-funding-secures-cornwall-to-london-air-link>

- B.18 After the collapse of bmi regional in February 2019, the Department for Transport renewed the PSO from Derry/Londonderry to London with Loganair, initially to London Southend for two years. In March 2021, a further £4.37 million was secured for Loganair to resume services to London Stansted for another two years, providing financial support for airport operational costs. Half of this subsidy would be provided by the Department for Economy, while the rest was covered by the Department for Transport.
- B.19 In March 2021, Derry-Londonderry City and Strabane District Council submitted a proposal for £15 million worth of government funding to keep the airport running for the next six years; the airport currently costs £3.4 million to taxpayers each year. The council is also expected to submit a PSO application to the Irish government to maintain an airlink between Derry/Londonderry to Dublin.

Figure B.7: London Stansted- Derry-Londonderry – Operating performance – 2010-2017 (Ryanair)



Source: CAA, Steer analysis

Dundee

- B.20 A service to London City from Dundee was maintained by an assortment of airlines until December 2013, when CityJet announced it would be discontinuing the last of its services from March 2014 onwards. In June 2014, Dundee Airport’s operator Highlands and Islands Airports (HIAL) announced an agreement between them and Dundee City Council, Transport Scotland and Loganair to fund a twice daily service to London Stansted. The funding provided £2.85 million over two years, at a cost of £69 per passenger. This was renewed in 2017 at a cost of £3.7 million, where 50% of the total funds were provided for by the UK Government, £1.4 million provided by the Scottish Government and £400,000 by Dundee City Council, equating to a cost of £90 per passenger.
- B.21 In December 2019, funding for the PSO from London to Dundee was renewed for 11 return services a week, for another two years. Loganair announced Dundee would be served by London City Airport from March 2020, replacing its Stansted service.

Teesside

- B.22 In 2018, the Tees Valley Combined Authority announced a funding package to purchase the 89% majority shareholding of Teesside International Airport (then Durham Tees Valley

Airport). This move intended to bring the airport back into public ownership for the first time since 2003, with an initial airport operator agreed to be Stobart Aviation in 2019.

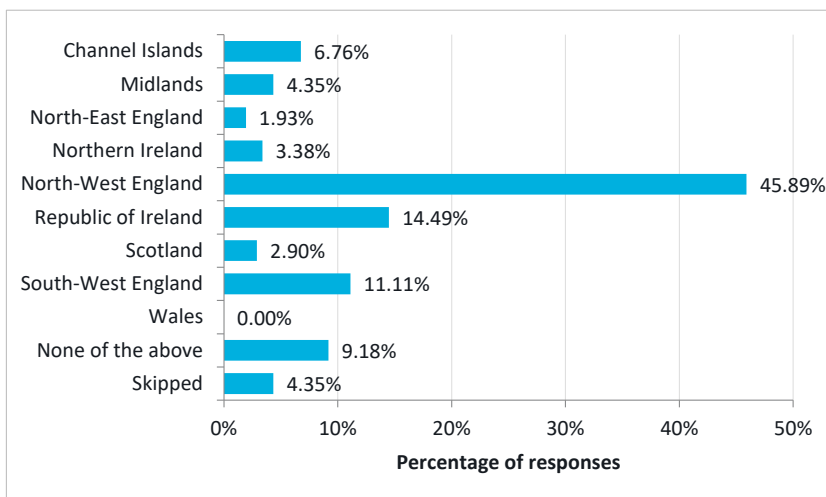
- B.23 In July 2021, Esken (formerly Stobart Aviation) announced their withdrawal from operating at the airport and the sale of their 25% stake back to the Tees Valley Combined Authority. Later, the council announced a further £10 million of funding to support the airport.
- B.24 Further public subsidies were employed to secure the launch of various new routes from the airport. Details such as amounts and utilisation of public spending were withheld due to commercial sensitivity reasons, however one of the new routes secured from Teesside international was with Eastern Airways to London, initially to London City in July 2020, before changing to London Heathrow in August 2020. Loganair announced they too would launch a service to Heathrow from spring 2021, with three daily services on weekdays from July onwards. The airline shares a codeshare agreement with British Airways which allows tickets from Teesside to reach 134 onward destinations. Currently, only the Loganair service to Heathrow is still in operation.

C Needs analysis survey

Business - Regional

C.1 Of the respondents, 216 identified as passengers who required air transport predominantly for business requirements. The figure below shows the primary region (excluding London) required for air travel by respondent, where nearly half of the responses indicated the North-West of England was most important for connectivity. Significant demand for the Republic of Ireland and for the South-West of England was also evident. This result is understandable, given the existing frequency of flights to the cities of Liverpool, Manchester and Bristol. However, it should be noted less than 4% of respondents cited a primary requirement for air links to Northern Ireland, given services to Belfast already exist, whereas over four times as many respondents noted a link to Ireland (presumably Dublin) as their most important air link, yet no service to the Republic of Ireland is currently operating.

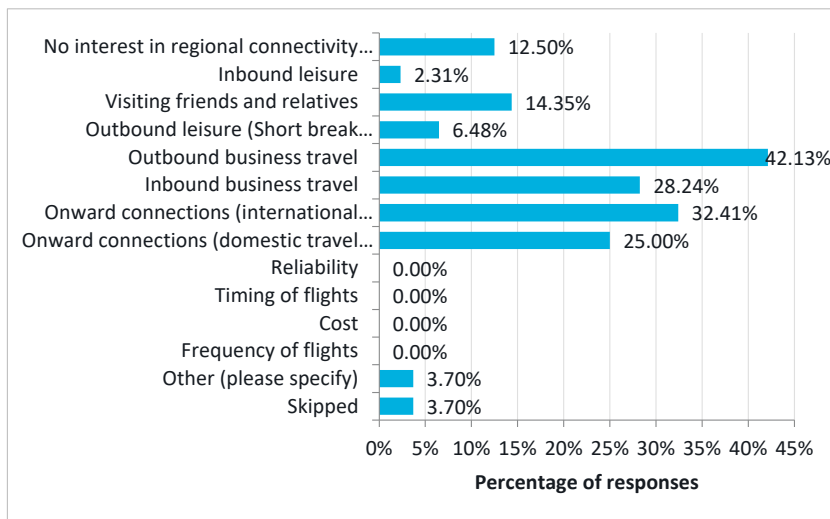
Figure C.1: Business Regional - Please select your most important region for air links (excluding London).



Source: Isle of Man Government Questionnaire, Steer analysis

C.2 The reasoning behind why each respondent chose their most important region is presented in the figure below. Approximately two out every five respondents required their primary air link for outbound business travel, while an approximate one in three required onward international connections and one in four required domestic connections by road or rail.

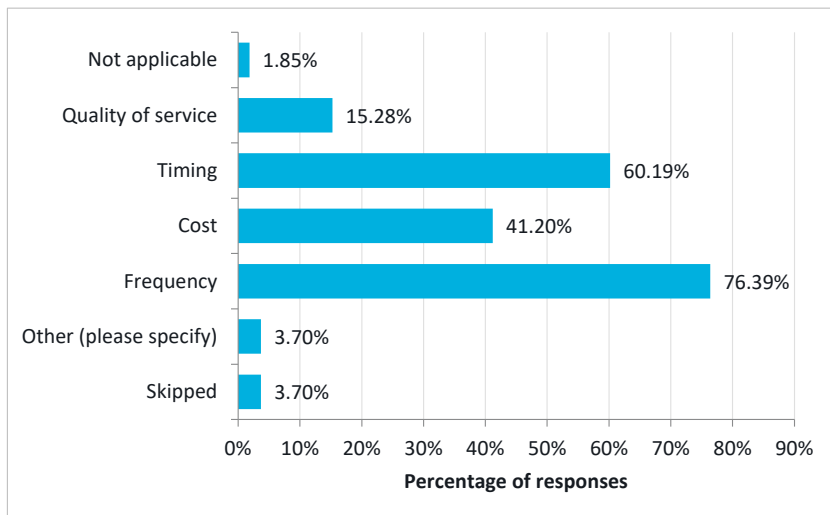
Figure C.2: Business Regional - Please indicate the reasons for selecting this region.



Source: Isle of Man Government Questionnaire, Steer analysis

C.3 The most important features of the air link to each respondent’s most important region are shown in the figure below. Notably, the most important features of the air link for business passengers are related to the schedule of the service, where three out of four responses indicated frequency as important and three out of five indicted the timing was important as well. Cost was important for less than half of respondents and the quality of service was only important for c15% of travellers.

Figure C.3: Business Regional - What features are most important to you for air services to this?

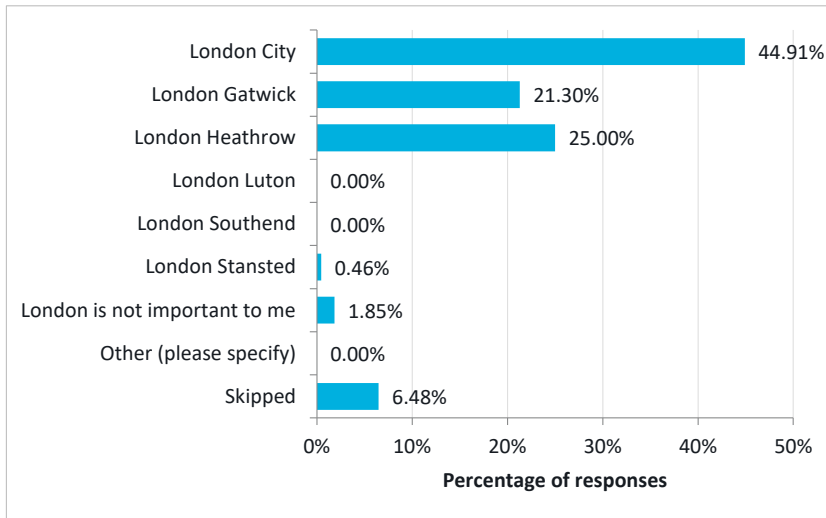


Source: Isle of Man Government Questionnaire, Steer analysis

Business - London

C.4 The primary airport of choice for travel to London is shown in the figure below, where over 90% of respondents thought either London City, Gatwick or Heathrow were most important for travelling to London. On successive questioning of which airport was second most important, c86% of respondents answered one of the same three airports again.

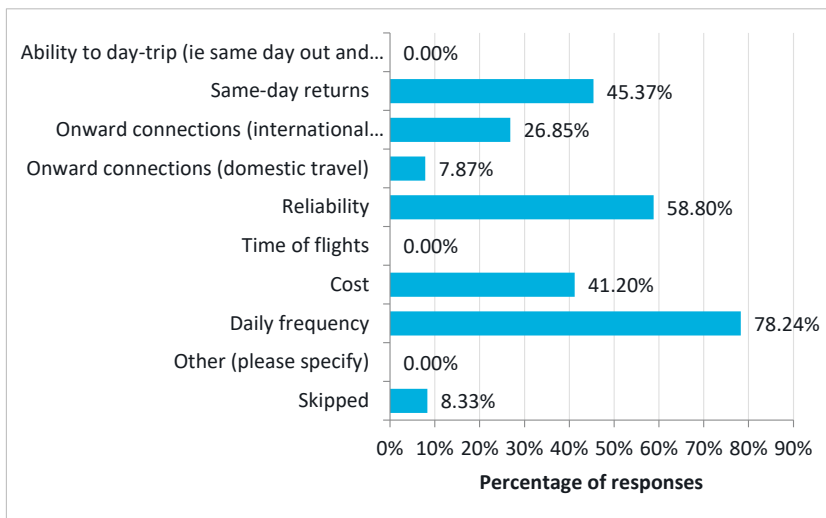
Figure C.4: Business London - Which is the most important London route for you?



Source: Isle of Man Government Questionnaire, Steer analysis

C.5 The three most important factors for each respondent’s most important London airport are shown in the figure below. In similar fashion to Figure C.3, frequency of flights is most important three out of every four respondents. The next most popular factors include reliability of service, the ability to return on the same day and cost of flights.

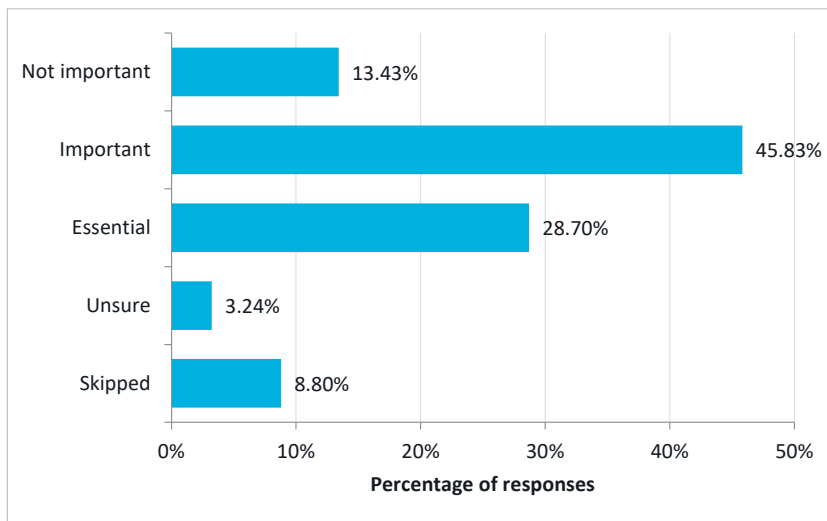
Figure C.5: Business London - Thinking of the London route you state is the most important, select the top three factors in terms of importance



Source: Isle of Man Government Questionnaire, Steer analysis

C.6 When asked how important a day return service was to their most important London airport, only approximately one in four respondents did not state that the route was either important or essential for them, as shown in the figure below.

Figure C.6: Business London - How important is a day return service on your preferred London route?

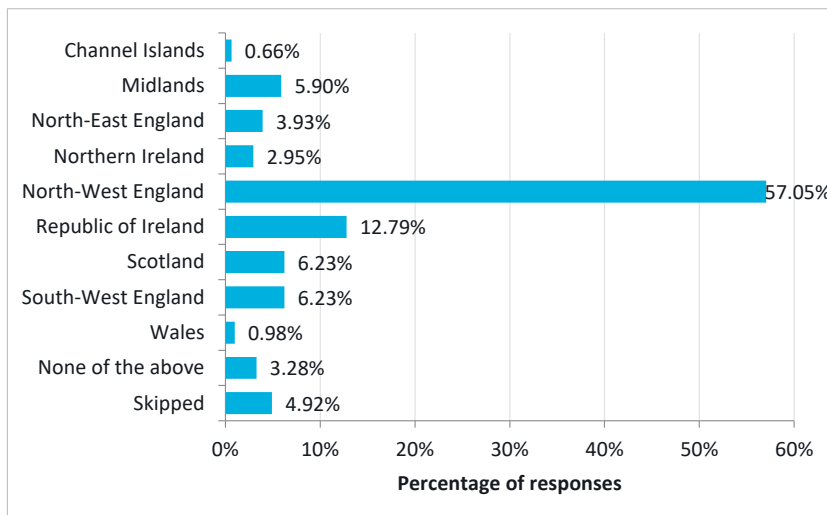


Source: Isle of Man Government Questionnaire, Steer analysis

Leisure - Regional

C.7 Of the total number of respondents surveyed, 320 identified themselves as passengers requiring air links for leisure reasons. Over half of leisure respondents cited links to the North-West of England as being most important to them, while approximately one in ten felt links to the Republic of Ireland were most important, as shown in the figure below. This was a similar finding to that for business passengers, where the demand for flights to Ireland as most important was more than double that to some destinations which already have existing air services, while the Republic of Ireland currently does not.

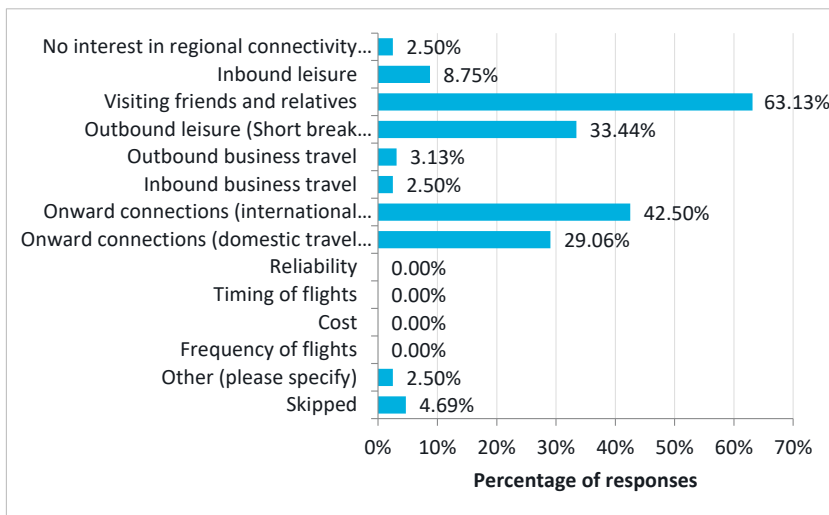
Figure C.7: Leisure regional - Please select your most important region for air links (excluding London).



Source: Isle of Man Government Questionnaire, Steer analysis

C.8 The reasoning behind this is provided in the figure below. The majority of respondents noted the ability to visit friends and relatives as an important reason for requiring regional air links, while other popular reasons included onward international connections, short break leisure and onward domestic connections.

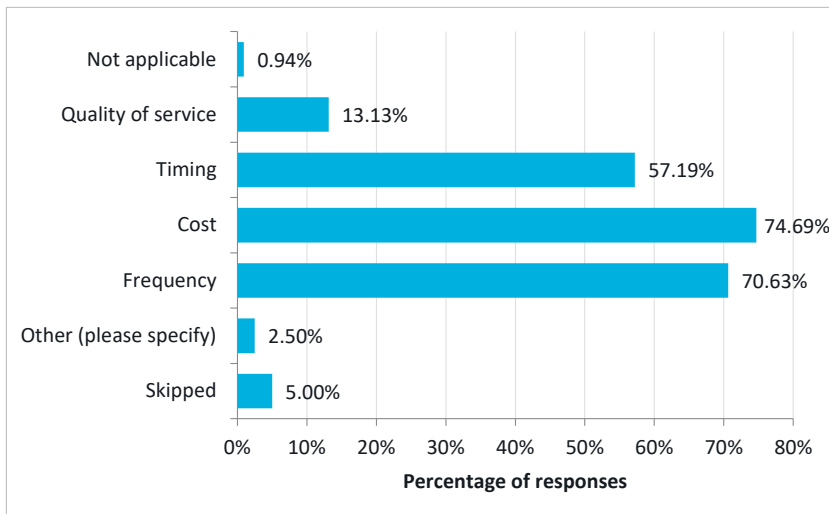
Figure C.8: Leisure Regional - Please indicate the reasons for selecting this region.



Source: Isle of Man Government Questionnaire, Steer analysis

C.9 Cost was the most important factor for leisure passengers, with approximately three out of four respondents stating it as an important feature of travelling to the region they chose in Figure C.7. However similarly to business passengers, over 70% of leisure respondents stated frequency of flights as important and over half noted timing as important as well. Notably, quality of service was the least popular factor with leisure passengers as well as for business travellers.

Figure C.9: Leisure Regional - What features are most important to you for air services to this region?

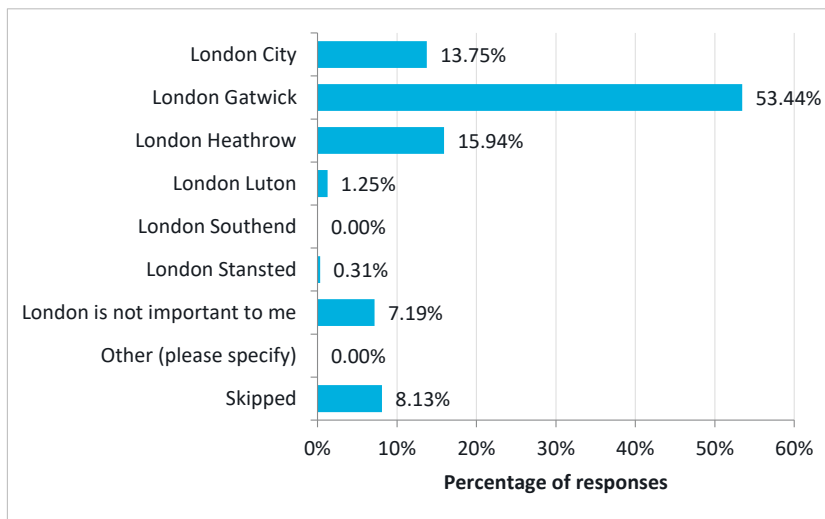


Source: Isle of Man Government Questionnaire, Steer analysis

Leisure - London

C.10 Where the business community identified London City as the most important London airport to serve the Isle of Man in Figure C.4, the figure below shows that leisure passengers prefer London Gatwick as most important when travelling to London. Similarly, over 80% of respondents would prefer to use either London City, Gatwick or Heathrow, and just less than 70% would prefer to use one of these three airports as second most important. Less than 2% of responses indicated a preference for Stansted or Luton.

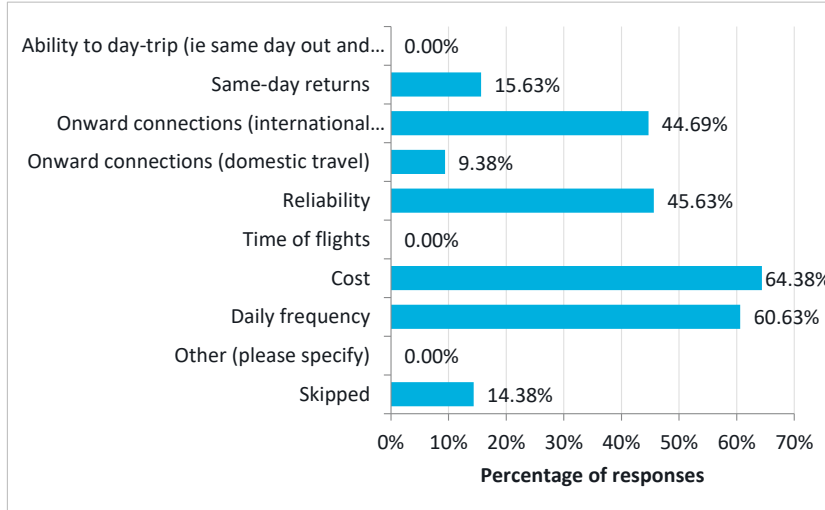
Figure C.10: Leisure London - Which is the most important London route for you?



Source: Isle of Man Government Questionnaire, Steer analysis

C.11 Cost featured as the most important factor for approximately three out of five leisure passengers travelling to London, as shown in the figure below. Similar to the responses from business passengers, reliability and frequency of flights were also important factors, however conversely, onwards international connections were more important to leisure passengers than the ability to return on the same day, with only c15% compared to c45%.

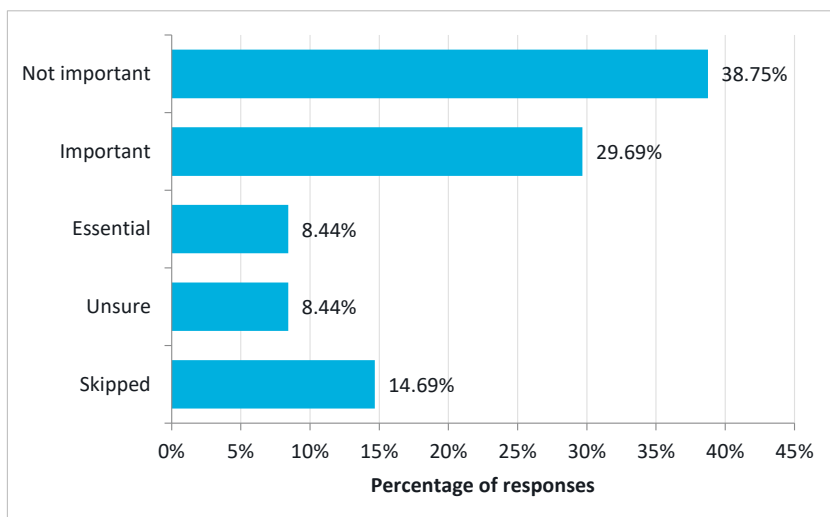
Figure C.11: Leisure London - Thinking of the London route you state is the most important, select the top three factors in terms of importance



Source: Isle of Man Government Questionnaire, Steer analysis

C.12 Around 62% of leisure passengers did not consider day-return services to London as important or essential compared with the 28% of business passengers who did not view a day return service to London as important or essential. This is shown in the figure below.

Figure C.12: Leisure London - How important is a day return service on your preferred London route?



Source: Isle of Man Government Questionnaire, Steer analysis

Summary of additional comments

C.13 The questionnaire provided respondents the ability to leave any additional comments if they wished. Of the 537 people surveyed, 93 submitted additional comments. These comments were categorised into broad topics, as presented in the table below.

Table C.1: Summary of additional comments by topic.

Topic	Number of respondents
Improvements to London connectivity	34
Improvements to Republic of Ireland connectivity	15
Improvements to Scheduling	11
Cost Improvements	4
Improvements to Europe connectivity	4

Source: Isle of Man Government Questionnaire, Steer analysis

C.14 Over a third of respondents who submitted optional comments mentioned a need for improved connectivity to London, of which 23 of the 34 respondents identified as business travellers.

C.15 Two thirds of comments mentioning improved connectivity to the Republic of Ireland/Dublin were from leisure passengers.

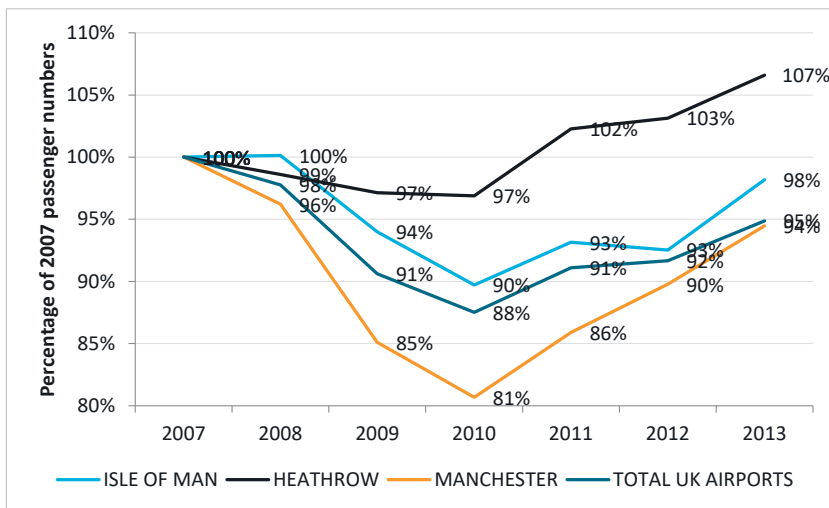
C.16 Several comments specifically referenced easyJet and the respondent’s opinion of their contribution to the Island. Leisure passengers primarily commended easyJet’s lower fares, however, other comments (primarily from business passengers) referenced their poor schedule commitment and increasing pricing.

D COVID-19 recovery

Historic traffic recovery

- D.1 An indication of how the Isle of Man’s air services will recover relative to the recovery of the entire UK aviation market can be made by comparing the Isle of Man’s historic passenger numbers to that of key UK airports in the aftermath of the 2008 Financial crisis.
- D.2 The recovery of passengers to/from the Isle of Man outperformed the UK average after the financial crisis showing the resilience of the market and also its reliance on air services for critical connectivity. Based on this analysis it is expected that the Isle of Man will also recover at a level at least equivalent to the UK average.

Figure D.1: Wider UK market – Indexed annual passenger numbers after the 2008 Financial crisis.

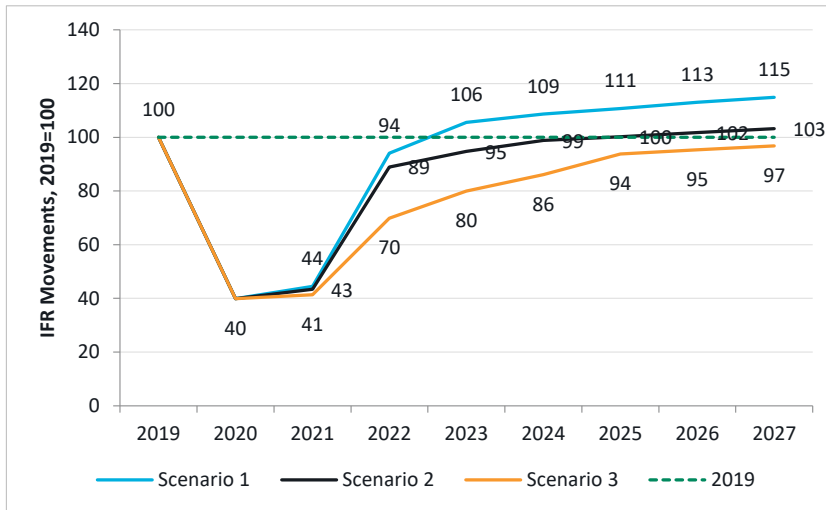


Source: CAA, Steer analysis

Outlook

- D.3 Eurocontrol published its latest forecast in October 2021, which provides three expected COVID-19 recovery scenarios. These are presented in the figure below. Scenario 2 represents the mid-scenario which has been used to influence the assumed recovery profile for the Isle of Man. The Eurocontrol forecast assumes that aircraft movements (inferred passengers) will recover to 89% of 2019 levels in 2022, 95% in 2023 and 99% in 2024.

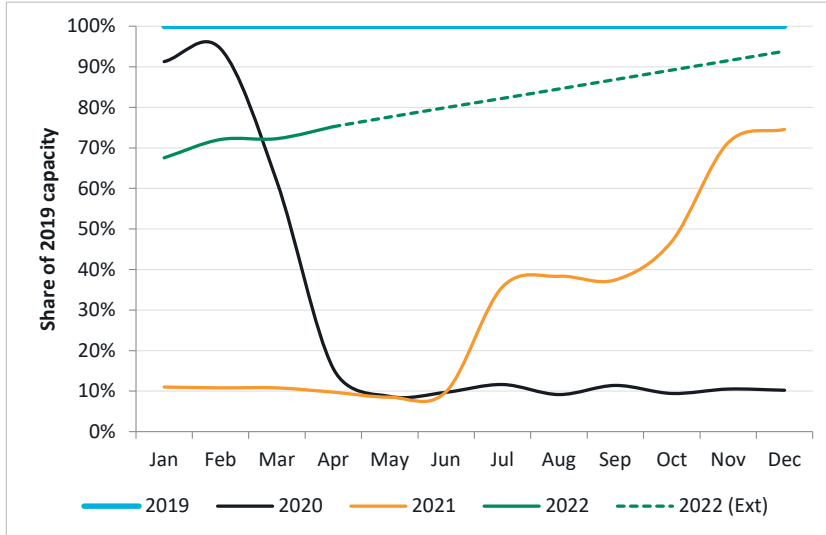
Figure D.2: Seven-year IFR movement forecasts for the UK with various scenarios.



Source: EUROCONTROL, Steer analysis

D.4 Forward looking seat capacity from OAG for 2021/2022 was compiled to allow an indication of traffic development in the short term to be derived. Available seat capacity is expected to significantly increase from November 2021 onwards and outturn 2021 passengers are expected to reach around 30% of 2019 passengers compared with 43% in the Eurocontrol scenario. Based on the trajectory of seat capacity available in 2022, it is expected that passenger traffic will return to around 82% of 2019 figures in 2022.

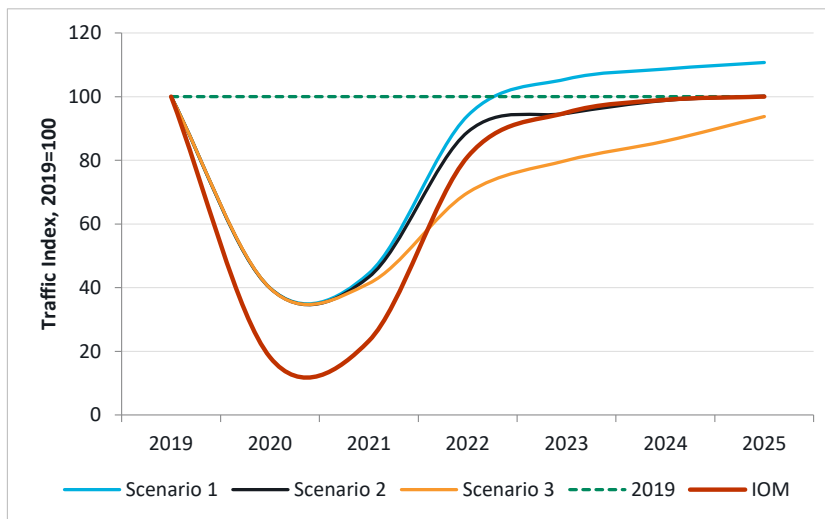
Figure D.3: Share of 2019 seats scheduled



Source: OAG, Steer analysis

D.5 From 2023 it is expected that passengers will recover at a rate at least equal to that of the Eurocontrol scenario. The combined assumed recovery profile is presented in the figure below.

Figure D.4: Assumed traffic recovery profile



Source: Eurocontrol, OAG, CAA, Steer analysis

D.6 There are risks to all forecasts, and this is no different. As a result of the March 2020 COVID-19 lockdown, businesses adapted to different ways of working. As an example, businesses have become accustomed to on-line meetings (MS Teams, Zoom, Skype etc). There remains a possibility that such business practices may remain, which would therefore lead to a slower recovery in business traffic, and therefore it could take a lot longer to return to 2019 levels.

E Public Service Obligation (PSO) routes within an EU context

- E.1 The role of PSOs under Regulation (EC) No 1008/2008 of the European Parliament on common rules for the operation of air services in the Community is to set fixed standards of continuity, regularity, pricing or minimum capacity to ensure access to isolated or developing regions when a Member State finds that objectives of regional development policy will not be met adequately if only left to a free play of market forces as the market itself will not deliver an acceptable level of air services to these regions. PSOs are an exception to the general principle of the freedom to provide air services within the EU, guaranteed under Article 15(1) of the Regulation.
- E.2 In its communication on ‘Aviation Strategy for Europe’ the Commission identified different needs of EU citizens and businesses, such as access to high quality air transport services, and considered that if the market itself does not deliver an acceptable level of air transport services to given regions within Europe, Member States may consider PSOs as an instrument to ensure service to and from under-served regions, i.e. to ensure connectivity where needed.
- E.3 There are currently 179 PSO routes established under Regulation No 1008/2008 in the EU, all located in twelve Member States (Croatia, Cyprus, Czech Republic, Estonia, Finland, France, Greece, Ireland, Italy, Portugal, Spain, Sweden) and the UK.
- E.4 In practice PSO routes are mostly domestic routes with only seven routes linking airports located in two different Member States. 136 of the current PSO routes are subsidized by the public authorities. Indicatively, it has been reported that when Stobart Air operated PSO routes between Dublin-Kerry and Dublin-Donegal they were partially subsidised by the Irish Government under a PSO running through to January 31, 2022. The airline received a EUR3.9 million annual payment for the Donegal route and EUR3.3 million for the Kerry service. Both services operated twice daily.

PSO - The legal framework

- E.5 The conditions and the requirements for PSOs are set out in Articles 16–18 of Regulation No 1008/2008. Article 16 sets out the general principles for PSOs. It contains criteria for PSO imposition and continuity requirements, assessment criteria for Member States, rules on the procedure for publication and on commencing operations on PSO routes, conditions and procedure for limiting the access to a route and also the procedure to be applied in case of emergencies. Article 17 stipulates how the public tender procedure shall be conducted. Finally, Article 18 contains the rules for examination and review of decisions taken under preceding articles.

PSO - The need for clarification of the rules

- E.6 The EU legal framework established by Regulation No 1008/2008 guarantees the openness, publicity and transparency of the procedure of imposing PSOs. Monitoring of the correct

application of the PSO rules is important in order to avoid any possible abuse of the system due to disproportionate competition restrictions vis-à-vis the social and economic objectives pursued. The Commission's objective is to give advice and to address as many potential issues as possible before the publication of the information notice concerning the PSO.

- E.7 In its Communication on Aviation Strategy the Commission committed to publishing guidelines clarifying the interpretation and the application by the Commission services of the rules and procedures governing PSOs laid down in Regulation No 1008/2008.
- E.8 These guidelines intend to explain the Commission's interpretation of the criteria used in the Regulation and describe the applicable procedures to be followed. The clarification of the rules and their interpretation should make it easier, in particular for those using PSOs the first time, to comply with the applicable rules.
- E.9 In addition to the experience gained by the Commission in the application of the rules on PSOs as laid down in the Regulation, these guidelines also take account of the State aid rules provided for in EU law (in particular Articles 107-109 TFEU).
- E.10 These guidelines provide indications relevant to most cases, but it should be emphasised that each case must be assessed on its own merits, in light of all its specific circumstances.
- E.11 In any event, the present guidelines are not intended to create any new legal obligations and they are without prejudice to the interpretation that could be provided in the future by the Court of Justice concerning PSOs.

PSO - General principles

- E.12 It follows from Article 16(1) and (4) of Regulation No 1008/2008 that Member States need to inform the Commission about any intention on their part to impose PSOs. The publication of information notices does not convey legal certainty about a given outcome; its objective is informing the market about the Member State's intentions regarding a new PSO. While the Commission does not take a formal decision on the PSO as such, it is still very important to clear any issues that might be detected before a PSO is put into place or modified and raise concerns in the future. The Commission advises Member States to make contact with its services as early as possible when they start considering imposing a new PSO or modifying an existing PSO.
- E.13 An important particularity of PSOs in the air transport sector is the clear distinction between the PSO regime that sets out the conditions to operate on a particular route and the contract that gives an exclusive right (with or without compensation) to an operator. The imposition of a PSO in the air transport sector does not necessarily and automatically create the right for the Member State concerned to restrict the access to the air route to a single operator or to grant compensations for the fulfilment of the PSO (so-called 'restricted PSO'). If an air carrier demonstrates its willingness to operate the route without exclusivity and compensation, then the access to the route must remain free to any air carrier respecting the conditions of the PSO (so-called 'open PSO').
- E.14 Under the Regulation PSOs may in particular be used to ensure the access to remote and isolated regions or under certain conditions, where market forces alone do not allow a minimum provision of air transport services satisfying certain standards.
- E.15 As PSOs are an exception to the general principle of the freedom to provide air services, PSOs are subject to strict requirements and limitations. The PSOs should respect the principles of

transparency, non-discrimination and proportionality: in particular, they cannot introduce any discrimination based on the nationality or the identity of the air carriers and they cannot go beyond what is needed to attain the policy objectives.

PSO - Eligible services and routes

E.16 Type of services - PSOs may only be imposed on scheduled air services

E.17 Type of routes - Regulation No 1008/2008 allows the imposition of PSOs on two types of routes:

- **Routes to an airport serving a peripheral or development region** - A peripheral region is typically a remote region or a region accessible with difficulty from the capital and other main cities in the Member State. The remoteness and isolation should be assessed with regard to the territory of the Member State, its administrative, business, education and medical centres, but also with regard to the territory and such centres of other Member States with which it shares a border. A development region is lagging behind economically, as measured for example by GDP per capita or by unemployment rate.
- **Thin routes to any airport** - The Regulation does not define a quantified criterion to assess the 'thinness' of a route, given the various situations that may prevail in different Member States. However, based on the Commission's experience in a large number of PSO cases, it appears safe to say that a route with traffic of more than 100,000 passengers per year cannot normally be considered as a thin route within the meaning of the Regulation. Regulation No 1008/2008 does not limit PSOs to routes within one and the same Member State. They may very well be applied to any intra-EU route that fulfils the conditions of the Regulation. PSO routes to third countries are not covered by the Regulation, as its scope is confined to intra-EU air services.

It follows from Article 16(1) of the Regulation that the PSO route is always to be defined from one airport to another, and not with reference to two cities or regions. The selection of the airport for the purpose of PSO should be properly justified. Onward connectivity – i.e. the destinations and frequencies offered by the airports of the destination city – is one element in this assessment, but it cannot be the only justification for the choice of a specific airport over another. Alternatively, if a public authority considers that several destination airports would serve one region's needs equally, it could impose a PSO from an airport in that region to these several destination airports, thereby imposing a PSO on these separate routes. If an air carrier starts operating on one of these routes or if an air carrier is selected for one route after a public tender including all these routes, the other PSOs must then be repealed, so that the market is not unnecessarily closed. Even though this configuration is not explicitly contemplated in Article 16(1), the terms of the provision do not oppose it, and it is also in line with the objectives of the provision. In order to avoid unequal treatment and distortions of competition, it is important though to make the authority's intentions transparent from the beginning, notably through the communication referred to in Article 16(4) of the Regulation.

PSO - The vital character of the route

E.18 PSOs may only be imposed on routes that are 'considered vital for the economic and social development of the region which the airport serves'. This is a necessary condition for any of the above-mentioned type of routes, and the assessment is always to be performed taking into account the specific circumstances of the case. Member States enjoy a certain margin of discretion when it comes to judging the vital character of a route. However, this discretion has

to be exercised on the basis of objective factors regarding connectivity needs in accordance with the Regulation, as well as EU law more generally.

E.19 An indispensable route for a region, such as a small island or a remote region, presents clearly this vital character. However, air services linking small and medium-sized cities to important economic or administrative centres could also be regarded as vital for the economic and social development of the regions in question under certain circumstances. For example, a PSO regime has been imposed on a route linking the capital of an island Member State to Brussels, as the city where various EU institutions and bodies have their offices.

E.20 However, Article 16(1) of the Regulation poses limits to the margin of discretion of the Member States. For example, while PSOs could be designed to lift hurdles to the economic and social development of regions or cities, they cannot be established with the aim, directly or indirectly, to promote or support a particular air carrier or to develop a particular airport.

PSO - Necessity and adequacy of the obligations

E.21 The necessity and the adequacy of the envisaged PSO is to be determined on the basis of the four criteria below:-

- **Proportionality to the economic and social development needs** - This criterion is a direct expression of the general proportionality principle. It bears a close relationship with the proviso of Article 16(1), according to which PSOs may be imposed only on routes which are vital for the economic and social development of the region which the airport serves. It follows from Article 16(3)(a) that the obligations themselves should be in proportion to the economic development needs of the region concerned. The PSOs cannot impose restrictions on the provision of air services that go beyond what is necessary to fulfil the needs in question.
- **Inadequacy of alternative transport modes** - PSOs should only be imposed insofar as other transport modes cannot meet the transport needs of the region concerned. Account should be taken mainly of services offered by train, ferry and coach operators. The adequacy of the services should be assessed, in particular, with regard to their frequency, journey times, departure times and to possible connections to other important destinations, in particular long-haul travel options. The possibilities of individual (car) transport should also be explored, having regard in particular to the journey times by road.
- **Existing air fares and conditions** - The necessity and the adequacy of PSOs as required by the Regulation should also be assessed with regard to the air fares and the conditions quoted to users. PSOs can include requirements on maximum tariffs if this is deemed necessary, because otherwise the tariffs would be excessive in the context of the economic needs of the region concerned. A PSO limited to setting a maximum price could be envisaged in specific cases. A steep rise in prices and decrease in passenger numbers over a short period of time may, according to the case, be an indication that a price ceiling is necessary.
- **The combined effect of existing air transport supply** - Whether PSOs are needed will ultimately depend on the combined effect of all air carriers operating or intending to operate the route. If the existing provision of air services already satisfies the mobility needs of the concerned region, then there is no 'market failure' that would deserve to be addressed, and a PSO would not be necessary. The Commission takes the view that a PSO regarding the transport of passengers would normally not be considered justified on routes where there are a critical number of passengers (based on experience, such a

critical number would normally appear to materialise as from 100,000 passengers per year) and on which several air carriers are operating all year round. As a matter of general principle, in cases where air carriers are already operating on the route concerned, the assessment of the impact of the obligations should be carried out with particular care: excessive obligations (e.g. imposing price caps, schedules or number of frequencies) may have the counterproductive effect of reducing the offer of air services. It should be noted that imposing a PSO only for the purpose of ensuring the transportation of cargo and mail is also possible. In each case, it has to be assessed how the above factors play out, in their combination where applicable.

The assessment of the existing air transport supply should also take account of indirect air services and of other nearby airports. Imposing PSOs on a route to a particular airport if an indirect connection with a reasonable transfer time already exists (e.g. one hour or less) or if adequate services to a nearby airport are already available (e.g. airports serving a same city or region, including also airports in neighbouring Member State) would require a particularly robust justification. The way the domestic and international traffic is distributed between those airports may play a role in this respect. If another airport that is farther away than 100 km and/or the travelling time is more than one hour by public transport, it is generally reasonable to question whether the two airports can be seen as alternatives. However, this analysis always needs to be conducted case-by-case, taking into account the specific circumstances. Generally speaking, a PSO is more likely to be justified in cases where there are no existing services to other airports in the close vicinity of the airport being considered

Viability of a PSO route to London Heathrow (LHR)

- E.22 Given the above process for identifying the eligibility for a service from IOM to LHR it is considered on the face of it that such a route would not meet the key eligibility tests, namely:-
- Services to London Gatwick already exist (easyJet) with annual passengers/seats available greater than 100,000 and would therefore indicate that there is no market failure on this route;
 - London Heathrow and London Gatwick are most likely to be considered as serving the same market with similar public transport travel times to central London for business purposes;
 - Previous UK regional airports (Newquay, Londonderry, Dundee) seeking PSO routes to London initially advertised tenders for all London Airports (Heathrow, Gatwick, Luton, Stansted, London City and Southend Airports) thereby reinforcing the point that a route to London on a PSO basis would be served if any London Airport was served; and
 - A key component of seeking a PSO route to London Heathrow would be for worldwide connections that in turn would be most appropriately served by British Airways (BA) or one with access to a BA codeshare. This requirement may fail the test of seeking a specific airline to operate a PSO route.
- E.23 Given the above analysis, it would appear that progressing with the process to seek a PSO route on the IOM-LHR sector would have a low probability of success and may trigger a competition issue complaint from easyJet or a need to formally establish the London Gatwick service as a PSO route given that the IOM seeks London as a PSO route.

F Route profitability/ route cost methodology

Methodology

F.1 Using a combination of publicly available and paid-for sources, average operating costs per seat were calculated for a variety of aircraft types on the route between the Isle of Man and:

- Liverpool;
- Manchester;
- London Heathrow;
- London Gatwick; and
- London City.

F.2 The following aircraft types were included.

Table F.1: Aircraft types assessed

Code	Aircraft	Seats	Current operators
319	Airbus A319 Jet	126-156	easyJet, British Airways
320	Airbus A320 Jet	150-186	easyJet, British Airways, Wizz
E90	Embraer E190 Jet	98-112	BA Cityflyer, Aurigny ²⁹
AT7	ATR 72 Turboprop	72	Loganair, Stobart Air, Aer Lingus Regional
DH4	Dash 8 400 Turboprop	78	Flybe
S20	Saab 2000 Turboprop	50	BA Cityflyer
ER4	Embraer E145 Jet	49	Loganair
AT7	ATR 42 Turboprop	48	Loganair

F.3 The cost of operating the above aircraft types on each route was calculated using information from the following sources.

Table F.2: Operating cost sources and assumptions

Item	Assumption/Methodology
Landing charges	Obtained from IATA Airport Charges guide and cross referenced with airport charging schedules. Allowances for peak and off-peak pricing included. These charges are levied per aircraft movement, regardless of passenger load.
Passenger charges	Obtained from IATA Airport Charges guide. These charges are levied per passenger.

²⁹ Aurigny operate the slightly larger E195 variant (122 seats). This aircraft type is not permitted to fly to/from London City.

Item	Assumption/Methodology
Fuel costs	Fuel cost were determined from aircraft fuel burn tables (by distance) and applying a fuel cost of £0.40 per litre.
Other costs	Other airline operating costs (crew, aircraft, navigation, overheads) were estimated from airline financial accounts, and based on a cost per Available Seat Kilometre (ASK).
APD	Assumed to remain at £13 for inbound and outbound passengers.

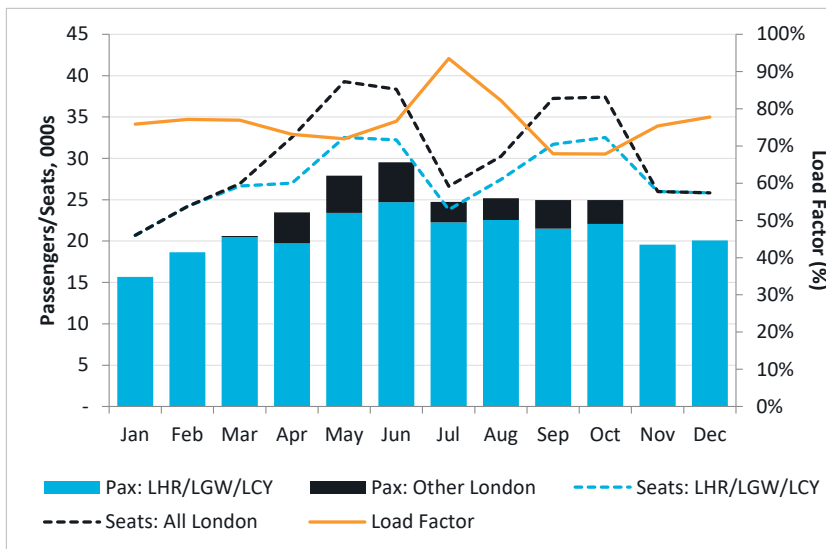
F.4 The costs for the outbound and inbound sectors have been combined. Airlines with significant passenger volumes are assumed to receive significant discounts off the published IOM airport charges.

Tailoring capacity to demand

London

F.5 To enable both the environmental and financial sustainability of operations, the capacity of operations with different aircraft types has been aligned with perceived demand. The figure below presents monthly passengers on London routes in 2019, together with capacity operated and the average monthly load factor across all routes. The monthly load factor varied between 72% and 93% over the year, averaging at 75%³⁰. A drop in capacity can be seen in July and August, likely due to aircraft capacity being diverted to other more ‘profitable’ routes in the peak summer months. Passengers peak in May and June primarily driven by the Isle of Man TT races.

Figure F.1: London market passengers and capacity, 2019



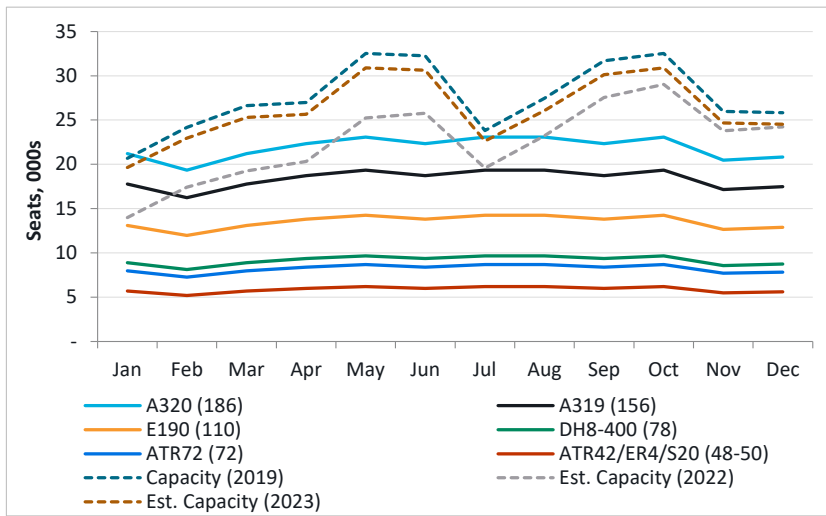
Source: IOM Government, OAG, Steer analysis

F.6 The figure below presents estimated required capacity to cater to expected monthly demand resulting from the COVID-19 recovery profiles together with capacity provided by different aircraft types flying two daily rotations to London. In 2022, even two daily rotations by the largest aircraft currently flown to the Isle of Man does not satisfy demand requirements from

³⁰ For LHR/LGW/LCY and all London airports the load factor profile was virtually identical and one has been presented.

May onwards. Note the numbers in brackets represents the seat capacity on each aircraft type).

Figure F.2: Capacity provided by 2 x daily flight by aircraft type

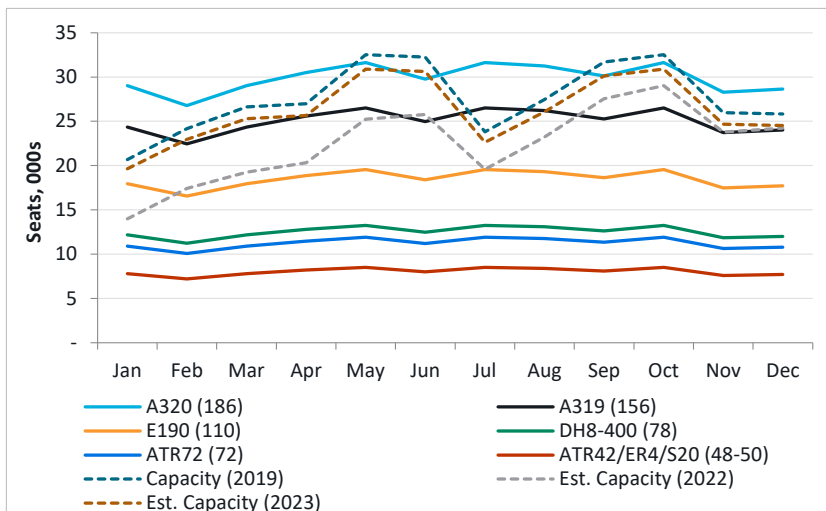


Source: IOM Government, OAG, Steer analysis

F.7

With three daily rotations, demand is satisfied by flying the largest aircraft type in the peak months, however this creates over-capacity at other times of the year. Notably three daily rotations operated by regional aircraft (with a capacity of circa 70 seats) will not be sufficient to satisfy the overall IOM-London demand. The continued use of larger ‘mainline’ aircraft will be required to ensure the continued provision of sufficient capacity to meet demand in the London market without necessitating a very high frequency schedule that is likely not possible due to slot constraints in the London market. A 70 seat aircraft would require an average of 7 daily frequencies to meet demand, increasing to nearly 10 daily frequencies for a 50 seat aircraft.

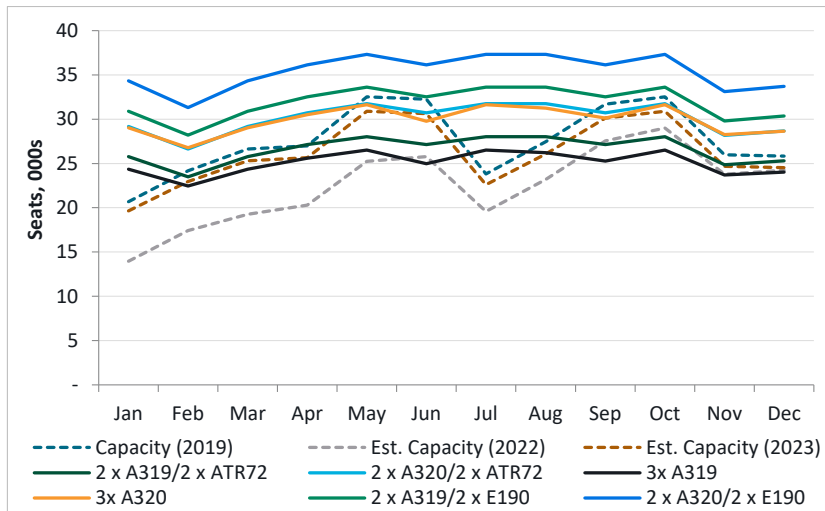
Figure F.3: Capacity provided by 3 x daily flight by aircraft type



Source: IOM Government, OAG, Steer analysis

F.8 The figure below shows the capacity provided for various combinations of aircraft types, which provide an envelope of capacity sufficient to supply demand due to seasonality and demand from key events.

Figure F.4: Capacity provided by aircraft combinations



Source: IOM Government, OAG, Steer analysis

F.9 In order to provide sufficient capacity on the London route either the following combination of flights should be secured to a:

- Three times daily flight with ‘mainline³¹’ aircraft to either London Gatwick or London Heathrow; or
- A twice daily flight with ‘mainline’ aircraft to either London Gatwick or London Heathrow and a twice daily flight with a regional aircraft to either London Heathrow or London City (serving two different airports). Further frequencies could be possible depending on the usage of the London route by passengers with connections.

Route costs

London Heathrow

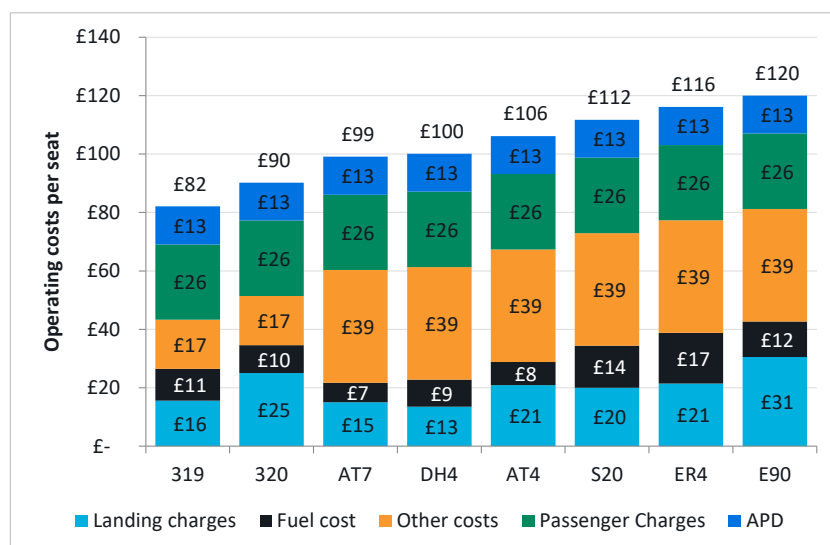
F.10 Operating costs per seat vary between £82 per seat (on an Airbus A319), increasing to £120 (Embraer E190 or E145).

Charges

F.11 Passenger charges at London Heathrow were very competitive for domestic passengers and amounted to around £14 per departing passenger when an allowance for PRM charges and checked baggage have been included. Landing (and take-off) charges are heavily dictated by aircraft noise emissions; as the majority of aircraft evaluated are towards the lower end of the charging scale. These charges are also reasonable when compared with other London airports. London Heathrow is currently charging an additional recovery charge of £8.9 per departing passenger and is expected to nearly double landing and take-off charges in 2022. The operating costs per seat presented below are based on expected 2022 charges at Heathrow.

³¹ Mainline aircraft refers to A319/A320 or B737 sized aircraft, which have capacity for 150-186 passengers

Figure F.5: Average operating costs per seat – London Heathrow



Source: IATA, ICAO, Steer analysis

Access

- F.12 Whilst in financial terms Heathrow is very competitive with the other London airports, obtaining access to slots will be difficult. Heathrow is heavily slot constrained, and obtaining slots, especially in peak/desired times is both difficult and expensive.
- F.13 The UK permits secondary trading (the ability to trade slots for money), however slots can only be acquired by airlines and not by governments or other bodies for the provision of a service.
- F.14 In the wake of the COVID-19 pandemic many airlines have managed to commence services to Heathrow (Loganair, JetBlue, Vistara), however it should be noted that due to the slots waiver introduced as a result of the pandemic, these airlines will not accrue grandfather rights on these slots and instead they will revert to their original owners (Summer 2019/Winter 2020 season operators) when the waiver is removed. Analysis of data from the UK slot coordinator ACL shows that no slots have been transferred to Loganair so it can be inferred that they are operating to Heathrow on a temporary basis (such as the flights from Teesside) whilst there is excess capacity available.
- F.15 There are currently three options for obtaining access to Heathrow:
- Partner with an airline, which currently has a large slot portfolio;
 - Partner with an airline and lease slots from another airline which is willing to do so; or
 - Set up an airline and purchase slots on the open market.
- F.16 Leasing slots from another carrier would work in the short-term as demand remains substantially below 2019 levels and airlines would be willing to lease out excess slots, especially when the slot waiver is removed. This option however would not support a long-term service as the leasing carrier may wish to take the slot back as demand recovers and they want to increase their own operations. In the same way, if flights were provided by an airline which currently has a large slot portfolio at Heathrow, these slots may get repurposed for more profitable services as demand recovers.
- F.17 The option for the Isle of Man Government to purchase slots for services to/from the Island is currently not permitted and would require an airline to be established. Providing funding for

another carrier to purchase slots would be a risky endeavour as this airline could later repurpose them for their benefit.

Connectivity

- F.18 Heathrow is one of the largest airports in the world, with a wide range of airlines and destinations to Europe and beyond. Optimum connectivity with these airlines and destinations would ideally require an airline to have an interline arrangement with these airlines at Heathrow- where multi-sector itineraries through to the end destination can be made with just one booking – or better still a codeshare arrangement, where the airline from the Isle of Man carries the same airline code as the airline operating the following leg of the journey.
- F.19 An airline may enter into several interline and codeshare agreements with multiple airlines. However, as British Airways is by far the largest carrier with the widest portfolio of destinations at Heathrow, it would therefore be the most logical and optimal airline with which to seek any interline or codeshare agreement.

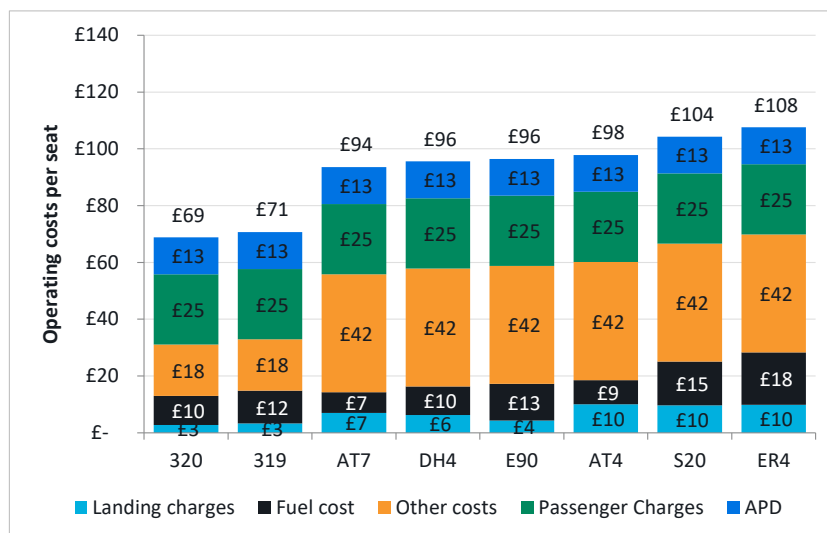
London Gatwick

- F.20 Operating costs to London Gatwick are comparable with those to Heathrow, varying between £69 per seat on aircraft such as the A320 and increasing to £108 on smaller aircraft such as the Saab 2000.

Charges

- F.21 Full passenger charges at London Gatwick are less than those at Heathrow for domestic passengers and amount to around £22 per departing passengers when an allowance for PRM charges and checked baggage have been included. Landing (and take-off) charges are heavily dictated by the time of operation, with four sets of charges being levied dependent on whether flights are operated in the Peak, Base, Off-Peak times in the summer or in the winter season. The landing charges below are based on double daily rotation with one pre-9am arrival.

Figure F.6: Average operating costs per seat – London Gatwick



Source: IATA, ICAO, Steer analysis

Access

F.22 As with Heathrow, London Gatwick is also heavily slot constrained and it is difficult to obtain slots from the pool and like at Heathrow there is a secondary slot market at Gatwick where slots are readily bought and sold.

F.23 Similarly, there are three available options to access slots at Gatwick:

- Partner with an airline, which currently has a large slot portfolio;
- Partner with an airline and lease slots from another airline which is willing to do so; or
- Set up an airline and purchase slots on the open market.

F.24 easyJet currently has a large portfolio of slots at Gatwick, which has increased in size since March 2020 due to easyJet obtaining slots from Norwegian and Virgin Atlantic.

F.25 Aurigny obtained 6 daily slot pairs at London Gatwick in 2003, when the airport was not operating at capacity and slots were obtainable from the pool.

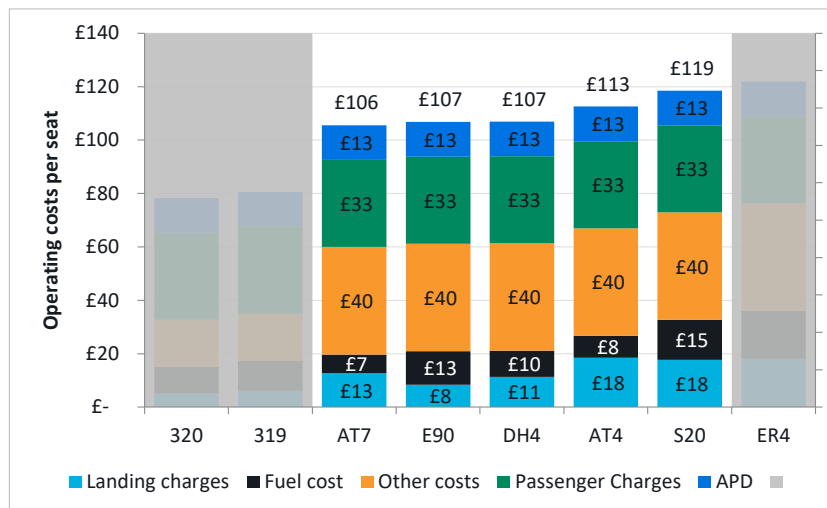
Connectivity

F.26 Worldwide by easyJet allows connections to be made onto their European network at Gatwick as well as onto numerous carriers at Gatwick, including Air Transat (Canada), Cathay Pacific (Hong Kong), Emirates (USA) and WestJet (Canada).

London City

F.27 Operating costs to London City are more expensive than Heathrow or Gatwick due to high landing costs and limitations around the types of aircraft that can land there. The ATR72, ERJ190 and Dash 8-400 all incur similar costs per seat (£106-107), whilst the ATR42 and Saab 2000 are more expensive at £113 and £119 respectively.

Figure F.1: Average operating costs per seat – London City



Source: IATA, ICAO, Steer analysis Notes: A320, A319 and ER4 are not permitted to fly to LCY

Charges

F.28 Full passenger charges at London City are considerably more expensive than those at other London airports and amount to around £37 per departing passenger. Landing charges are heavily dictated by the time of operation, with four sets of charges being levied dependent on whether flights are operated in the Premium, Peak, Shoulder or Off-Peak times. A twice daily

schedule suited to business passengers requires a premium and a peak set of landing charges to be paid.

Access

F.29 Slots are available from the pool at London City, even during peak times.

Connectivity

F.30 BA Cityflyer operates a range of short-haul routes from London City to primarily business and high-end tourism destinations in Western Europe. Flights are also operated by other European legacy carriers (KLM, Lufthansa and Swiss) to their respective hubs.

Option cost methodology

F.31 Costs associated with service development have been estimated from the route costing exercise together with assumed revenues based on 2019 revenues. Additional costs resulting from the requirement for crews to stay overnight in the Isle of Man have also been included.

F.32 Service development options have been structured to fit 2019 traffic levels and thus no benefit from additional visitor revenues have been assumed.

F.33 The total costs associated with each of the options could be supported through either commercial incentivisation provided through the airport or with a PSO contract.

F.34 The impact of both a reduction (50%) and the removal of IOM APD has been quantified based on the market response to reduced fares. Reduced fares will stimulate passengers and consequently an increase in airport and visitor revenues slightly offsets the loss of revenue to the exchequer incurred under this option.

F.35 For completeness, the estimated costs of establishing a Manx airline have been included. The set up cost of this operation will be prohibitive and the airline will immediately encounter difficulties in securing slots in desired market. Additionally, the operating costs base of this airline will be higher than competitors owing to the lack of ability to generate economies of scale. It should be noted that the cost base of Aurigny per seat km (excluding airport charges and fuel costs) was estimated to be nearly double that of Flybe and five-times that of easyJet.

Economic benefit

F.36 The value of maintaining an operational airline base on the Island should not be underestimated as it permits:

- Rotation flexibility;
- Schedules to be operated ex-Isle of Man, permitting business day returns to key destinations;
- Reduced risk of operating delays, especially in the mornings due to weather and evenings due to accumulated delay; and
- Economic benefit to the Isle of Man due to the employment generated.

F.37 Jobs generated:

- 1 based aircraft (<100 seats) generates 16 direct job (4 Captains, 4 First officers and 8 cabin crew) with an estimated total salary benefit of £680,000; and
- Engineering centre – 6 engineers and 1 apprentice to service up to 3 aircraft with an estimated total salary benefit of £240,000.

