

National Assembly for Wales
Public Accounts Committee

**Intra-Wales - Cardiff to Anglesey -
Air Service - Interim Report**

July 2014



Cynulliad
Cenedlaethol
Cymru

National
Assembly for
Wales

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Public Accounts Committee

The Committee was established on 22 June 2011. The role of the Public Accounts Committee is to ensure that proper and thorough scrutiny is given to Welsh Government expenditure. The specific functions of the Committee are set out in Standing Order 18. The Committee will consider reports prepared by the Auditor General for Wales on the accounts of the Welsh Government and other public bodies, and on the economy, efficiency and effectiveness with which resources were employed in the discharge of public functions.

Current Committee membership



Darren Millar (Chair)
Welsh Conservatives
Clwyd West



William Graham
Welsh Conservatives
South Wales East



Mike Hedges
Welsh Labour
Swansea East



Alun Ffred Jones
Plaid Cymru
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Sandy Mewies
Welsh Labour
Delyn



Julie Morgan
Welsh Labour
Cardiff North



Jenny Rathbone
Welsh Labour
Cardiff Central



Aled Roberts
Welsh Liberal Democrats
North Wales

The following Member was also a member of the Committee during this inquiry:



Mohammad Asghar (Oscar)
Welsh Conservatives
South Wales East

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Chair's foreword / Summary

The current contract for the Intra-Wales Air Service expires in December 2014. This interim report by the Public Accounts Committee examines the value for money aspects of the current arrangements and seeks to inform the decision making process regarding the future of the Service, noting that passenger numbers have fallen by 43 per cent since their peak in 2008-09. Should the Welsh Government decide to press ahead with a further procurement exercise then this will provide an opportunity to ensure that the significant value for money concerns that this report has identified are addressed.

At the outset of our inquiry the Committee determined that given the timescales for decision making around the future of the Air Service we would only take evidence from the Welsh Government and from Martin Evans, an aviation expert from the University of South Wales who had been involved at various points with the tendering process for the existing Air Service. Wider evidence, such as comparisons with the Scottish islands-to-mainland services or the comparable cost of subsidised routes using other means of transport, such as the Arriva Trains Wales North-South link, may inform further work by the Committee at a future date.

Some of the Committee's concerns may have been addressed by the independent research already commissioned by the Welsh Government into the Air Service. However, despite a number of attempts to ascertain full details of the scope and timetable of this work, these have remained elusive. It is essential that the Government make any future decisions on a sound evidence base and we have therefore recommended that the Government publish more information on this research and its findings.

This is the first report the Public Accounts Committee has published arising from an inquiry which we have initiated. The subject matter is of significant public interest and, no matter what the future arrangements may be, we hope that our findings and recommendations will assist in securing value for money for taxpayers.

The Committee's Recommendations

Recommendation 1. The Committee recommends that the Welsh Government use an independent source to verify data on passenger numbers using the Air Service and that data on passenger numbers be published on a regular basis in the future. (Page 12)

Recommendation 2. We recommend that the Welsh Government monitor any future discrepancies between the data it is supplied with by the operating airline and the data reported by the CAA. (Page 12)

Recommendation 3. While noting the recent increase in advance bookings, the Committee recommends that the Welsh Government commissions independent research into the longer term trend, which shows a decline in passenger numbers. (Page 14)

Recommendation 4. The Committee recommends that the Welsh Government include an explicit requirement in any future tender, for a comprehensive marketing programme to be undertaken by the successful bidder. Evaluation of this marketing programme should be incorporated into the overall evaluation of the bids and specified in any subsequent contract. (Page 15)

Recommendation 5. The Committee recommends that information on passengers using the Air Service be collected to determine the reason for travel (e.g. business or leisure) and the sectors in which business passengers are employed and to what extent journeys are funded by the taxpayer. Such information should be published and collected on a regular basis. (Page 16)

Recommendation 6. The Committee recommends that the Welsh Government makes public the full scope, content, methodology and timetable for the ARUP review. We further recommend that the findings of this review are published when available, in order to satisfy the areas of concern the Committee has around the information used to inform decisions on the future of the Air Service. (Page 19)

Recommendation 7. Given the concerns that have been expressed in relation to the potential for lack of clarity regarding liabilities under joint contract arrangements, the Committee recommends that the Welsh Government keep a watching brief of the investigation into the Cork air

crash and reflect on the outcome in any future Air Service contract.

(Page 22)

Recommendation 8. The Committee recommends that, should the Welsh Government tender for a new Air Service, every possible step (such as pre-consultation) be taken to increase the number of bidders for the contract without compromising the overall timetable ahead of the expiry of the current contract. (Page 26)

Recommendation 9. The Committee recommends that, given the new flexibility under the Public Service Obligation rules, the Welsh Government explores possible options to maximise the benefits and opportunities presented by the Air Service in the future. (Page 33)

1. Introduction

1. The Public Accounts Committee (the Committee) requested a memorandum on the Intra-Wales – Cardiff to Anglesey – Air Service¹ (the Air Service) from the Auditor General for Wales and agreed to undertake a short inquiry on this matter at its meeting on 21 January 2014.
2. The Committee took evidence from Welsh Government officials and, from Mr Martin Evans, an aviation industry expert from the University of South Wales.
3. The short inquiry considered issues relating to the overall value for money of the Air Service, in the context of the expiration of the current contract in December 2014. The Committee also explored issues specific to previous and current contracting arrangements.
4. The following report details the Committee's interim findings and the Committee will return to this issue after the Welsh Government announces its future strategy for the Air Service, prior to the current contract's expiration in December 2014. The Welsh Government's review of the Service is on-going and our report is intended to be used to inform future strategy should the Welsh Government decide to continue its support for the service.
5. It is therefore anticipated that when the Committee returns to this issue the Welsh Government's intentions for the Air Service would be clear and any tendering process for a new Air Service contract would be complete.

¹ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014

2. Background

6. The Air Service provides twice-daily weekday flights between north and south Wales (between RAF Valley, Anglesey and Cardiff) and has operated since 2007. The Air Service is currently operated through a contract between the Welsh Government and two companies who are joint signatories: Citywing provides the ticketing and marketing functions and Links Air operates the flights. The current contract expires in December 2014. Previously the service had been operated by Highland Airways (between May 2007 and March 2010).

7. The Welsh Government provides a subsidy to the Air Service through a Public Service Obligation (PSO). EU Member States may provide scheduled air services through PSOs on air routes which are deemed vital for the economic development of the region they serve but which are not commercially viable in their own right. Member states must respect the conditions and the requirements set out in Article 16 of the European Commission's Air Services Regulation 1008/2008¹. For example, the regulations state that the airports used for the service should be linked to one another and to the city or conurbation they serve by frequent, reliable and efficient public transport services. The PSO is a subsidy to compensate the operator for the deficit incurred in providing a service which would not otherwise be commercially viable. In the case of the Air Service, the cost of the PSO contract is currently capped at £1.2 million a year.

8. Several other parties are involved in the delivery of the Air Service including the Ministry of Defence, which owns RAF Valley, Cardiff Airport and a separate contractor (Europa) that operates the terminal building at RAF Valley. The Isle of Anglesey County Council manages the contract with Europa and also pays on to RAF Valley lease and landing fees, all underpinned by Welsh Government grant funding worth up to £300,000 a year at present.³

² European Commission's Air Services Regulation 1008/2008

³ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014

3. Costs, Performance, and Benefit Analysis

9. The Committee considered the costs and performance of the Air Service, and whether there had been sufficient benefit analysis of the Air Service.

Costs

10. The Auditor General's memorandum detailed that the total cost associated with the Air Service from 7 May 2007 to 31 March 2013 was £9.01 million.⁴ This included:

- the initial £1.5 million capital cost of developing the civil terminal building at RAF Valley;
- the Air Service contracts; and
- the grant funding to the Isle of Anglesey County Council for the costs associated with running the terminal building and for lease/landing fees at RAF Valley.

11. The costs of the PSO contract have been significantly higher under the current contract (capped at £1.2 million a year) than for the original contract (submitted as an £800,000 a year contract). The Auditor General's memorandum notes that this increase was due mainly to higher landing fees at Cardiff Airport and increased fuel costs.⁵

Performance

12. The Auditor General's memorandum provided a summary of the overall performance of the Air Service. Between 7 May 2007 and 30 April 2013 65,073 passengers used the service. This would be equivalent to an average PSO subsidy per passenger of around £86.⁶ During the first two years of the Highland Airways contract – May 2007 to April 2009 – nearly 29,000 passengers used the service with an average reported load factor of 82 per cent. This performance compared favourably with an

⁴ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraphs 44 and 45 and Figure 2

⁵ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 32

⁶ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 47

industry average load factor over the same period of around 76 per cent.⁷

13. However, the memorandum also highlighted that passenger numbers have been markedly lower in recent years, falling by 12.5 per cent between 2011-12 and 2012-13.

14. The Auditor General's memorandum showed the trend in monthly passenger numbers between May 2009 and October 2013 and was based on data supplied to the Wales Audit Office by the Welsh Government. However, the Committee noted that the passenger number figures referenced in evidence provided by Martin Evans, which were sourced from the Civil Aviation Authority, were different to those presented in the Auditor General's memorandum. The Committee queried the apparent discrepancy in the figures provided by the Welsh Government to the Wales Audit Office and those sourced from the Civil Aviation Authority.⁸

15. The Director General stated that the operator and civil aviation authority collect data differently, which may explain the discrepancy in the figures presented.⁹ He added:

“The other thing that is important to point out is that this is not just something that affects this particular flight or this particular airport. If you look at most flights across most airports, there is a discrepancy between the two sets of data.”¹⁰

16. Despite the Director General's explanation the Committee remained concerned about the discrepancy between these figures and sought further clarification from the Welsh Government. Written correspondence from the Welsh Government set out:

“The CAA and the operators of the Cardiff to Anglesey PSO Service do report different passenger numbers. On average, the passenger numbers supplied by the Air Service operator are higher than the CAA figures. It is not in the commercial interest for the operators of the Cardiff to Anglesey PSO Service to provide us with incorrectly high passenger data. This information

⁷ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraphs 46-51 and Figures 3 and 4

⁸ Record of Proceedings, 25 March 2014, paragraph 19

⁹ Record of Proceedings, 25 March 2014, paragraph 20

¹⁰ Record of Proceedings, 25 March 2014, paragraph 27

is used to set their budgets and their subsidy requirements. The differences in passenger data held by the CAA and the operator are greatest in 2012 and 2011 when the airport was under different ownership. The recording and handling of data will be considered during the next phase of the review of the service.”¹¹

17. The Committee note that while there were significant discrepancies in passenger data in previous years, since the start of 2012 this discrepancy has decreased and is now relatively small. We believe that an independent verification of the figures is essential to ensure that value for money is achieved.

The Committee recommends that the Welsh Government use an independent source to verify data on passenger numbers using the Air Service and that data on passenger numbers be published on a regular basis in the future.

We recommend that the Welsh Government monitor any future discrepancies between the data it is supplied with by the operating airline and the data reported by the CAA.

18. Both sets of figures, however, did indicate a reduction in passenger numbers. The Committee raised concerns about this with the Welsh Government and queried what work was being undertaken to understand why there had been a decrease.¹² The Director General stated:

“I would absolutely agree that that is a significant fall. There seems to be a number of reasons for that. The first is the general economic downturn. We think that that relates to around 10% of the fall—not 10% of the 35%, but 10% out of the 35%. The balance appears to be as a result of the interruption in service, which put people off using the service. I was a bit sceptical about that, but I have spoken to a number of operators that say that that is an entirely plausible argument.”¹³

19. The Director General further explained:

“Also, there is the fact that Cardiff Airport declined significantly more than other regional airports over the past few years, before the Welsh Government took ownership of it, and that around 40%

¹¹ Written Evidence, PAC(4)-11-14 (paper 4), 29 April 2014

¹² Record of Proceedings, 25 March 2014, paragraphs 11 - 13

¹³ Record of Proceedings, 25 March 2014, paragraph 16

of the passengers using the north-south service connect into another service. The view expressed by operators, not just the current operator, but other operators, was that if the on-going flights are significantly poorer, people just will not use the service. So, we think that it is a combination of the economic downturn, the break in service, and the poor performance of Cardiff Airport. There is evidence to suggest that, over the last four to five months, passenger numbers have been picking up quite significantly.”¹⁴

20. As outlined below subsequent figures from the Welsh Government demonstrate that in recent months there has been an increase in passenger numbers and advance bookings in comparison to previous years:¹⁵

Welsh Government Response:

Recent monthly passenger numbers (passengers carried), since October 2013:

Oct 13: 870

Nov 13: 821

Dec 13: 512

Jan 14: 631

Feb 14: 656

Mar 14: 785

Total: 4,275

Advance bookings taken at equivalent comparable points in previous years:

Mar 12: 481

Mar 13: 495

Mar 14: 574

21. The Committee questioned Martin Evans on why passenger numbers were decreasing, he explained that although he had not undertaken any recent work on passenger numbers using the Air Service, a rise in the minimum fare may have been a deterrent.¹⁶ Mr Evans added that:

“...what we found was that, although there was a maximum fare of £50, which has since been increased to slightly over £50, there were a range of fares at lower prices. At that time, there was a £15 fare and I think that the minimum fare now is around £19. We did find that people travelling on the cheapest fares were very

¹⁴ Record of Proceedings, 25 March 2014, paragraph 16

¹⁵ Written Evidence, PAC(4)-11-14 (paper 4), 29 April 2014

¹⁶ Record of Proceedings, 25 March 2014, paragraph 241

price sensitive, so if you put up that fare by a small amount, they would not travel or they would travel by a different mode.”¹⁷

22. The Committee was concerned there appeared to be little evidence to support the Welsh Government’s assertions on why there had been a decrease in passenger numbers. We believe that these assertions must be thoroughly tested and detailed consideration be given to the actual reasons for the decline in passenger numbers to build an accurate picture of the Air Service going forward.

While noting the recent increase in advance bookings, the Committee recommends that the Welsh Government commissions independent research into the longer term trend, which shows a decline in passenger numbers.

23. The Committee was told that marketing activity and pricing models for tickets can have a significant impact on passenger numbers. When asked about any action taken to promote the Air Service or to encourage additional marketing activity by the operators during the current contract term and the extent of influence that the Welsh Government has over the pricing model. The Welsh Government confirmed that:

“The ARUP review will include looking into a revised fares strategy, including the possibility of removing the maximum fare cap, to support maximising passenger numbers while balancing the revenue risk of the Welsh Government. It is at the service provider’s commercial discretion to offer fares at or below the maximum ticket price. It should be noted that Citywing operates a different commercial model to Highland Airways, with a greater focus on a reduced revenue risk.”¹⁸

24. The Welsh Government also clarified that in terms of marketing activity:

“The current contract allocates Citywing an annual budget of approximately £20k-£25k for its total marketing activity. Marketing and awareness raising activity undertaken includes radio advertising (Real/Heart); adverts in local publications: Cardiff Advertiser, Around Town (Cardiff, Swansea, RCT, Bridgend); attendance at the Swansea and Anglesey Air Shows; and also awareness raising activity through its charity work. It has

¹⁷ Record of Proceedings, 25 March 2014, paragraph 241

¹⁸ Written Evidence, PAC(4)-11-14 (paper 4), 29 April 2014

a comprehensive website and flights appear on comparison websites when searched.”¹⁹

25. The Committee believes that there is a need to improve the marketing of the Air Service to maximise its value for money. We would like to see better promotion of what the service offers including promoting related services, such as the connecting bus service, alongside the Air Service. The Committee believes that this type of promotional work should be specifically prescribed in the tendering process.

The Committee recommends that the Welsh Government include an explicit requirement in any future tender, for a comprehensive marketing programme to be undertaken by the successful bidder. Evaluation of this marketing programme should be incorporated into the overall evaluation of the bids and specified in any subsequent contract.

26. In addition to the number of passengers using the service, the Committee discussed the types of passenger using the Air Service. In particular, the Committee raised concerns about the proportion of passengers that were business travellers and, more specifically, the percentage of business travellers representing the public sector. The Director General informed the Committee that:

“The figures that we have indicate that between half and two thirds of all passengers using the north-south service are business travellers.”²⁰

27. The Director General explained that data relating to the proportion of travellers from the public sector was difficult to obtain and raised concerns about the quality of any such data collected.²¹ He added:

“The data would not necessarily be that fulsome. They would rely on—. You could ask everyone, but you would rely on honesty, obviously. That is something that we should look at. It is something that I have been asking for. It is not something that I am not interested in. I think that it is a valid and very important question. It does not necessarily mean, of course, that, if the proportion was 10% or 15%, it was necessarily a problem—that

¹⁹ Written Evidence, PAC(4)-11-14 (paper 4), 29 April 2014

²⁰ Record of Proceedings, 25 March 2014, paragraph 47

²¹ Record of Proceedings, 25 March 2014, paragraphs 59 - 62

would need to be balanced against time-savings et cetera. I quite agree that it is a completely valid and important question.”²²

28. The Committee is concerned about the lack of information on the proportion of travellers representing the public sector. The cost of these journeys would be wholly funded by the taxpayer²³ and in establishing the value for money of the public subsidy, this information would be important and relevant. While the Committee understand the difficulties in gathering this data accurately as people may not represent a single sector, we think that is not appropriate to have no data on this, and welcome the recognition of this by the Welsh Government.

The Committee recommends that information on passengers using the Air Service be collected to determine the reason for travel (e.g. business or leisure) and the sectors in which business passengers are employed and to what extent journeys are funded by the taxpayer. Such information should be published and collected on a regular basis.

Benefits evaluation

29. The Auditor General’s memorandum highlights that there has been limited benefits evaluation of the Air Service.²⁴ In 2008, a year after the Air Service was launched, the Welsh Government commissioned a study by Halcrow to evaluate the performance of the Air Service which found that “there is evidence to suggest that the Air Service has improved the quality of life for many passengers”.²⁵ The report also concluded that the Air Service had had a positive impact on many sectors of the Welsh economy.

30. However, since the 2008 study, there has been no further evaluation of the benefits of the Air Service. The memorandum notes that, without robust benefits evaluation, it could prove difficult for the Welsh Government to continue to justify any continued subsidy of the existing Air Service in terms of demonstrating that the service is vital for

²² Record of Proceedings, 25 March 2014, paragraph 63

²³ Record of Proceedings 25 March 2014, paragraph 58

²⁴ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraphs 52 – 54

²⁵ Halcrow, Monitoring of the Cardiff/Ynys MonAir Service, October 2008

the economic development of the regions it serves, especially in light of the apparent reduction in passenger numbers over recent years.²⁶

31. The Director General informed the Committee that the Welsh Government would be working with ARUP Consulting to review the market conditions for the intra Wales Air Service.²⁷

32. In written correspondence, the Welsh Government clarified that the terms of reference for ARUP highlighted that the main objective of the exercise is for the provider to explore and make suitable recommendations for the future of the PSO in Wales.²⁸ The correspondence also confirmed that this work is due to be completed in July 2014.

33. The Welsh Government detailed that the ARUP research intended to provide:

- a better understanding of the journey purposes of users of the service and their overall catchment area, and
- a better understanding of service users, both private and public sector, through analysis of demographic data.²⁹

34. The Committee questioned the Welsh Government on whether, in overall terms, it considered that the Air Service had provided value for money. The Director General told the Committee that the Welsh Government “feels the Air Service is delivering value for money otherwise we would not be doing it”.³⁰

35. The Committee sought evidence on the types of data being collected by Welsh Government to try and determine whether the Air Service delivers value for money or not.³¹

36. The Director General informed the Committee that:

“...we have information on passenger numbers. We have some idea, albeit not as good an idea as I would like, in terms of who is using the service, the balance between business and leisure,

²⁶ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 54

²⁷ Written Evidence, PAC(4)-11-14 (paper 4), 29 April 2014

²⁸ Written Evidence, PAC(4)-11-14 (paper 4), 29 April 2014

²⁹ Written Evidence, PAC(4)-16-14 (paper 12), 23 May 2014

³⁰ Record of Proceedings, , 25 March 2014, paragraph 6

³¹ Record of Proceedings, Public Accounts Committee, 25 March 2014, paragraph 9

numbers, load factors, and obviously economic growth in both north Wales and south Wales. We have been working with Arup, and economists at Arup, to try to understand this better. We are half way through a piece of work now, which will conclude fairly shortly, that will enable us to provide advice in good time to Ministers before the end of the contract.”³²

37. The Director General did highlight that taking forward a Public Service Obligation is about socioeconomic links which is a difficult activity to quantify, advising that:

“I think that that is the difficulty in both appraising a project before you do it and evaluating a project after you have done it. What has actually been the economic effect of that particular service is that there are lots of intangibles and lots of really good positive anecdotes. There are also lots of good data, but attributing data to a particular service is quite difficult, which is what we are trying to do now in as fair and honest a way as possible.”³³

38. The Committee is concerned by the evidence received about the data collection undertaken by the Government. It is essential to have good robust data to ensure value for money is being achieved. Given the public subsidy provided for the Air Service, the Committee would expect that the Welsh Government has in place effective mechanisms for understanding the market. We believe that a set of clear performance measures is needed in order for the Welsh Government to be able to demonstrate value for money. This is particularly important given the lack of experience for subsidising air travel in Wales. In developing these indicators, the Welsh Government may wish to consider the data collected for other subsidised public routes.

39. Despite trying to ascertain from Welsh Government the scope of the work being undertaken by ARUP, there remain a number of unanswered questions about the nature of this exercise.

40. The Committee would welcome further clarification on the scope, content, methodology and timetable for the review. We would also welcome an undertaking from the Welsh Government that they will publish the findings of this important review. The Committee would also

³² Record of Proceedings, Public Accounts Committee, 25 March 2014, paragraph 10

³³ Record of Proceedings, Public Accounts Committee, 25 March 2014, paragraph 8

be keen for ARUP to test the assertions made by the Welsh Government, such as the 40% of passengers using the north-south service to connect into another service, to ensure there is an evidence base for this.³⁴

The Committee recommends that the Welsh Government makes public the full scope, content, methodology and timetable for the ARUP review. We further recommend that the findings of this review are published when available, in order to satisfy the areas of concerns the Committee has around the information used to inform decisions on the future of the Air Service.

³⁴ Record of Proceedings, 25 March 2014, paragraph 16

4. Procurement and Contracting

Joint signatory arrangements: virtual airline ticketing agent and separate air carrier

41. The Auditor General's memorandum notes that, when re-tendering the Air Service contract in late 2009/early 2010, the only formal bid came from Highland Airways, the incumbent contractor.³⁵ The Welsh Government rejected this bid amidst concerns about the financial standing of Highland Airways. On 24 March 2010, Highland Airways ceased operating and the Air Service came to an abrupt halt.

42. The Welsh Government went out to tender again for a seven-month interim contract under the 'emergency procedure' provisions of the PSO regulations.³⁶ The Welsh Government awarded the interim contract to a consortium bid from Manx2/FLM Aviation. Following this the Welsh Government received correspondence from an airline that had not bid for the contract, stating that the PSO carrier must hold a valid Air Operator Certificate and that, as Manx2 was only a virtual airline, the contract was not legal.³⁷ The Welsh Government made clear that the bid was a consortium bid and that both organisations would be joint signatories to the contract³⁸ (with FLM providing the flying services and Manx2 operating as the ticketing agency).

43. In July 2010, the Welsh Government began the procurement process for a new full four-year Air Service contract. Manx2 and FLM were alone in submitting a formal [joint] bid. The Welsh Government's legal advice stated that to comply with the PSO regulations Manx2 and FLM needed, again, to be joint signatories to the contract.³⁹

44. In November 2012, Links Air took over the flying services from FLM after FLM accreditation as a licensed air carrier was removed. In January 2013, Manx2 transferred its assets to a new company called Citywing and the then Minister for Local Government and Communities gave his

³⁵ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraphs 23-24

³⁶ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraphs 25-31

³⁷ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 30

³⁸ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraphs 32-35

³⁹ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 33

approval to the novation of the PSO contract to Citywing on 23 January 2013.⁴⁰ The Committee has a number of concerns regarding the issuing of a joint contract due to the potential lack of clarity regarding where liabilities and responsibilities lie.

45. Written evidence from Martin Evans drew attention to a recent accident report by Ireland's Air Accident Investigation Unit relating to a fatal incident in February 2011 involving an operator operating on behalf of Manx2 at Cork Airport.⁴¹ The accident investigation is said to have been informed by issues relevant to the revocation of FLM Aviation's accreditation and the subsequent transfer of Manx2's assets to Citywing. Mr Evans's evidence also indicated that the accident investigation report recommended that the European Commission should review the role of ticket-sellers when engaged in providing air passenger services.

46. The Committee raised these issues with the Director General, particularly with regard to the awarding of any new contract in December 2014. He assured the Committee that "we are generally aware of the issues, and are generally aware of what the European Commission is doing".⁴² He added that:

"…we are operating, to a certain degree, not by being at risk, but by taking a risk-based approach to some of these aspects. We have not sought written confirmation from the European Union that everything that we are doing is, in its view, 100% okay, but the EU is aware of everything that we are doing and has not stopped us doing it, and it has not indicated that it wants to stop us doing it. Therefore, I do not think that there is any risk to the service prior to December [2014]."⁴³

47. On the issue of joint signatory arrangements and virtual airline ticketing agent and separate air carriers, the Committee questioned Martin Evans on the public service obligation rules on providing subsidy to these routes, particularly given his paper's suggestion that the arrangement in place, whereby a ticket seller and a licensed operator

⁴⁰ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraphs 31 – 41a

⁴¹ Written Evidence, PAC(4)-09-14 (paper 2), 25 March 2014

⁴² Record of Proceedings, 25 March 2014, paragraph 111

⁴³ Record of Proceedings, 25 March 2014, paragraph 111

were effectively joint signatories to a contract, was not within those rules.⁴⁴

48. Mr Evans clarified that:

“Clearly, the Government has had legal advice that it can appoint operators in this way, and there has been no challenge to the arrangement, so you have to assume that this arrangement is okay at the moment. My worry is not particularly about this form of arrangement. Obviously, it is used in other parts of the air travel industry. Basically, it is the same arrangement as if you went on holiday and travelled on a charter airline; there would be two companies involved, both regulated—the holiday company regulated financially and the air carrier regulated financially and operationally. I think that this arrangement could work well, and I do not think that the Government was wrong to pursue it.”⁴⁵

49. He added:

“The concerns of the Cork air crash investigators were that there was no separation of the operational functions of the ticket seller and of the air carrier, so that undue influence could be brought upon the air carrier by the ticket seller, because they were so closely integrated operationally. Also, at this level of operation, there is no financial regulation of the ticket seller. It can do whatever it likes.”⁴⁶

50. The Committee did not form an opinion on whether a joint contract is desirable, but believes that the Welsh Government ought to ensure consideration is given to any inherent risks of a joint operating model for the Air Service. In particular we are concerned about where the liabilities lie between the contractors. Given the similarities to the Welsh Government contract, it is important that the necessary consideration is given to the outcome of the investigation into the Cork air crash.

Given the concerns that have been expressed in relation to the potential for lack of clarity regarding liabilities under joint contract arrangements, the Committee recommends that the Welsh Government keep a watching brief of the investigation into the Cork

⁴⁴ Record of Proceedings, 25 March 2014, paragraph 242

⁴⁵ Record of Proceedings, 25 March 2014, paragraph 243

⁴⁶ Record of Proceedings, 25 March 2014, paragraph 244

air crash and reflect on the outcome in any future Air Service contract.

Retendering the Air Service contract

51. The Auditor General's memorandum notes that, when re-tendering for a new four-year contract in late 2009/early 2010, the Welsh Government attracted interest from six companies but that five companies pulled out after the Welsh Government decided against increasing the size of the aircraft from 18 seats.⁴⁷

52. When tendering for the interim contract for the May to December 2010 period, the Welsh Government attracted seven bids, although it deemed that three of these bids did not comply with its tender requirements.⁴⁸

53. When tendering again for a full four-year contract from December 2010 onward, the Welsh Government received only one bid for the contract, from the incumbent consortium contractors Manx2 and FLM.

54. In November 2012, the Welsh Government invoked the PSO emergency procedure to formally assign Links Air to the Air Service contract for seven months after FLM Aviation lost its accreditation as a licensed air carrier.⁴⁹ In adopting this approach and later assigning FLM Aviation to the contract for the remainder of the contract term (to December 2014), the Welsh Government took into account its previous experience of there being only one bidder for the full contract in late 2010.⁵⁰ The Welsh Government also sought advice from Martin Evans on the state of the aviation market, which had stated that competition for continuation of the service on the same scale was likely only to generate a response from the incumbent operator.⁵¹ The Welsh Government considered that re-tendering for the remaining contract term did not represent value-for-money.⁵²

⁴⁷ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 23

⁴⁸ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 29

⁴⁹ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 38

⁵⁰ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 40

⁵¹ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 39

⁵² Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 39

55. The Committee raised concerns with the Welsh Government about the time frame for any potential retendering of the contract. The Director General informed the Committee that the process would take "between four and six months"⁵³ so they would "need to be out to market this summer".⁵⁴ The Committee is concerned that despite trying to ascertain a more certain timeframe, the response from the Welsh Government has not been sufficiently clear or fulsome. Furthermore, we are also concerned that the indicative timeframe for this tendering process appears to provide for little contingency time available for the Welsh Government, should any issues emerge through the process.

56. In addition to the general concerns about the timeframe for the procurement, the Committee is concerned that there may not be sufficient time to attract new bidders. The Committee sought views from Martin Evans on whether there would be more interest and competition in any new Air Service contract beyond December 2014, particularly given the lack of interest during the 2010 tendering process. Mr Evans informed the Committee that:

"I am concerned, actually, that there will be less competition when the route goes out for tender this time. Looking at PSO routes across Europe, yes, you go out to tender on a Europe-wide basis but carriers tend to only go for routes in their own domestic markets. It is expensive to set up an operation in another country, particularly when you know from the start that you are limited to only a four-year operation. So, that tends to restrict the number of people who will tender for the operation. Also, the small, 19-seat operation is an operation that tends to disappear. Obviously, changes have happened in the air transport market over the last 10 years, with low-cost carriers becoming predominant, and it is difficult for operators of small aircraft to be competitive, given the fares offered by low-cost carriers. So, those routes with that size of aircraft are not operated as much as they used to be. There are also very large barriers for entry for new carriers to go into the air transport market. It is not as significant for operators at this level, because of the lower level of financial regulation that occurs with carriers with 19 seats and fewer, but it is still a difficult market to get into."⁵⁵

⁵³ Record of Proceedings, 25 March 2014, paragraph 96

⁵⁴ Record of Proceedings, 25 March 2014, paragraph 98

⁵⁵ Record of Proceedings, 25 March 2014, paragraph 248

57. During oral evidence, Mr Evans outlined other past concerns regarding the tendering process stating:

“I have had two concerns in the past. The first is a lack of engagement with the air transport industry. Where you have such a small pool of airlines likely to tender for a new contract, it would be sensible to have a consultation with them before you set out the specification for the tender. You could then issue a tender document that would maximise the benefits for the Welsh Government, because you would have a tender that somebody would respond to.”⁵⁶

58. Mr Evans added that:

“My second concern is that the contract itself—the tender—has not had enough of a quality element to it for the Welsh Government to maximise the benefits from the contract, such as favouring a carrier that would want to use the aircraft to introduce new routes, either from Cardiff or from Valley, to maximise the use of the aircraft. I have never thought it a sensible policy to have that aircraft sitting on the ground unused throughout the day, when we know that we are anxious in Wales to maximise the benefits from air transport. That could be done by making better use of that aircraft.”⁵⁷

59. The Committee welcomes the assurances from the Welsh Government that they would “...be looking to run a competitive dialogue... rather than just a standard procurement,”⁵⁸ as this would allow carriers to come forward with a number of suggestions on how to operate the Air Service.

60. Furthermore, in follow up correspondence the Welsh Government told the Committee that:

“The Welsh Government currently anticipates sufficient market interest to potentially hold a procurement exercise for a future Air Service in Wales. At this stage, we envisage any potential procurement process would be completed in time for a new

⁵⁶ Record of Proceedings, 25 March 2014, paragraph 278

⁵⁷ Record of Proceedings, 25 March 2014, paragraph 282

⁵⁸ Record of Proceedings, 25 March 2014, paragraph 107

contractor to provide a service following the expiry of the current contract.”⁵⁹

61. However we are still concerned about the short timeframe for this process. In order to ensure value for money, it is essential the Welsh Government utilises all the options available to it during the procurement process to ensure a competitive tendering process e.g. consultation before the procurement process to try and secure more than one bidder for the contract.

The Committee recommends that, should the Welsh Government tender for a new Air Service, every possible step (such as pre-consultation) be taken to increase the number of bidders for the contract without compromising the overall timetable ahead of the expiry of the current contract.

⁵⁹ Written Evidence, PAC(4)-16-14 (paper 12), 12 June 2014

5. Future of the Air Service

62. Although there has not been a clear indication from the Welsh Government about whether the Air Service will be retendered, the Committee considered a number of options for the future of the Air Service.

Consideration of Increasing the Size of Aircraft

63. The Auditor General's memorandum outlines the current Air Service schedule which, as has been the case since its commencement in May 2007, provides for two scheduled flights in both directions between Anglesey and Cardiff each weekday.⁶⁰ The schedule is planned so that a single aircraft, carrying 18 passengers, undertakes all four of the flights each day, offering the potential for up to 18,720 seats per year.⁶¹

64. Prior to the retendering exercise in 2009-10,⁶² the Welsh Government examined various options, including the possibility of increasing the size of the aircraft to 29 or 49 seats.⁶³ The Welsh Government then went out to tender based on a service using an aircraft offering between 29 and 50 seats.⁶⁴

65. During the procurement process the Welsh Government decided against increasing the size of the aircraft for reasons associated with the costs of Air Passenger Duty and the likelihood of securing sufficient growth in passenger numbers to justify the larger aircraft.⁶⁵ Current Welsh Government officials suggested to the Wales Audit Office that another reason for not increasing the size of the aircraft would have been that RAF Valley does not meet the requirements of the UK National

⁶⁰ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 5

⁶¹ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 6

⁶² Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraphs 18-24

⁶³ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 18

⁶⁴ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 19

⁶⁵ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 19

Aviation Security Programme for civilian aircraft with more than 18 seats.⁶⁶

66. The Auditor General's memorandum further explains that it was not clear to the Wales Audit Office from the documents reviewed whether the Welsh Government was previously fully aware of the security restrictions at RAF Valley when tendering for the Air Service contract and when commissioning external consultancy advice to support its consideration of increasing the size of the aircraft.⁶⁷

67. The Committee questioned Martin Evans on the Welsh Government's decision during the previous tendering process to reduce the size of the aircraft and the reasons given by the Welsh Government not only relating to capacity and security requirements as far as value was concerned, but also the costs associated with Air Passenger Duty.⁶⁸

68. Mr Evans explained that:

"Let me first go back to the decision not to go to a larger aircraft. When we undertook the first monitoring report, the load factors were up around 88%; a third of the passengers had experienced trying to book a ticket and not being able to get on the service. So, the service was being harmed at that time by passengers being turned away and not being able to get on the aircraft. At that time, it was imperative to move to a larger aircraft. The APD situation is that, on an aircraft of greater than 19 seats, Air Passenger Duty has to be charged. So, you immediately add £13 to the ticket cost for a one-way sector that has to be either paid by the passenger or absorbed by the operator in the maximum ticket price. The effect would be to increase either the amount paid by the passengers or the subsidy that has to be paid by the Government."⁶⁹

Increasing the Air Service

69. The Committee considered two potential options for increasing the Air Service – the potential for adding an additional stop, and the possibility of increasing the number of flying days from five to seven.

⁶⁶ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 20

⁶⁷ Intra-Wales – Cardiff to Anglesey – Air Service - Memorandum for the Public Accounts Committee, Wales Audit Office, 20 March 2014, paragraph 21

⁶⁸ Record of Proceedings, 25 March 2014, paragraph 272

⁶⁹ Record of Proceedings, 25 March 2014, paragraph 273

Location of the Airport in North Wales and potential for adding an additional stop

70. The Committee questioned Martin Evans on the limitations presented at RAF Valley and the need to establish a restricted zone to accommodate a larger civilian aircraft.⁷⁰

71. Mr Evans informed the Committee that:

“They would either have to make changes at Valley to ensure compliance—I am not sure what those changes would have to be—or indeed, as you say, go to another airfield in north Wales. Obviously, Caernarfon was considered at the same time as Valley. The Government chose Valley because a number of the operational costs were then covered by the RAF. However, it would be possible to do another appraisal to see what those costs would be in using another airfield. Using another airfield would gain other benefits for the route. At the moment, the route is restricted by the operating hours at Valley. It is not terribly user-friendly at the moment. Travellers would prefer, certainly on the return journey, to travel much later in the afternoon than is presently the case. That is restricted by the operating hours at Valley.”⁷¹

72. In light of this evidence, the Committee asked Mr Evans whether there was a case for using one of the other airports in North Wales, either Hawarden or Caernarfon, and making the necessary alterations to enable either of these airports to accommodate larger aircraft.⁷²

73. Mr Evans responded informing the Committee that:

“Hawarden would not be possible, in my view, because there is a competing mode of transport that is adequate, namely the rail service, and, therefore, under the PSO rules, you would not be allowed to impose a PSO on that route. As I said previously, Caernarfon was considered before; it was not considered competitive in terms of the amount of work that would have to be undertaken. Subsequently, the work undertaken at Valley was actually more expensive than was previously thought, so that analysis may not have been valid. Of course, on operational

⁷⁰ Record of Proceedings, 25 March 2014, paragraphs 253 - 255

⁷¹ Record of Proceedings, 25 March 2014, paragraph 256

⁷² Record of Proceedings, 25 March 2014, paragraph 260

costs, Valley is an expensive terminal to operate just to have two flights daily. Certainly, Caernarfon thought that it would not be as expensive, but you would have to do the analysis to find out whether that is so.”⁷³

74. The Committee raised the issue of including a stop at Hawarden with the Welsh Government and queried whether this option has been explored in more detail. The Director General told the Committee that:

“On the Hawarden link specifically, it was looked at; we are looking at it again now. There are significant questions around what would be the best type of route, however. So, you could have a three-legged journey to Anglesey, on to Hawarden and then back to Cardiff. The view of operators is that that would eliminate lots of benefit to travellers from north Wales, and so you would see a massive dip in passenger numbers and a dip, therefore, in economic benefits.”⁷⁴

75. This response appears inconsistent with previous Welsh Government advice which suggested that the PSO rules were a reason for not adding other stops to the service.⁷⁵ The Committee is concerned that given that the Welsh Government was aware of the PSO rules before it started engaging in the tendering process, the Director General was unable to provide an answer when asked why the business case was predicated on a three-stop service (Swansea- Cardiff-Anglesey).⁷⁶

76. This is a matter of concern for the Committee. In order to run a successful procurement process there must be a sound business case. We would welcome reassurances from the Welsh Government that the business case now accurately reflects the service provided.

Increasing the number of flying days

77. The Committee questioned whether there were any opportunities to make the service more viable if it were a seven-day-a-week service in terms of increasing for example tourism opportunities. The Committee queried what consideration the original business planning had given to the restrictions arising from RAF Valley being a military base and

⁷³ Record of Proceedings, 25 March 2014, paragraph 261

⁷⁴ Record of Proceedings, 25 March 2014, paragraph 79

⁷⁵ Record of Proceedings, 25 March 2014, paragraph 186

⁷⁶ Record of Proceedings, 25 March 2014, paragraphs 186 - 187

therefore only a five-day service was possible rather than a seven-day service.⁷⁷

78. The Director General responded stating:

“...I think that it was taken into account. So, people were not assuming something that was then not delivered. It is something that can be explored as part of the next contract to see whether we can get a seven-day-a-week operation, if a seven-day-a-week operation was deemed to be economically viable. That takes you straight back into who is using the service.”⁷⁸

79. The Head of Rail/Air Commitments Operations at Welsh Government further clarified that:

“...the RAF has jurisdiction on RAF Valley and that is something that was an issue before. Clearly, it would still be something that would have to be, and will be, explored in this procurement exercise, whether or not RAF Valley could be open at the weekends. However, the RAF has overall jurisdiction on that airfield.”⁷⁹

Changes to State Aid Rules

80. The Committee discussed recent changes to state aid rules affecting the PSO subsidy and sought clarity from the Welsh Government on the additional flexibility that these changes may provide should the Welsh Government decide to continue its subsidy of a North/South Wales Air Service beyond December 2014.

81. In written correspondence, the Welsh Government clarified that:

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

⁷⁷ Record of Proceedings, 25 March 2014, paragraph 202

⁷⁸ Record of Proceedings, 25 March 2014, paragraph 203

⁷⁹ Record of Proceedings, 25 March 2014, paragraph 203

additional routes and consider the reduction of current contract downtime.

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

“For example, hypothetically, a new PSO Cardiff–Anglesey return service could run twice daily (at the beginning and close of each business day, Monday–Friday). With this service, the aircraft would sit stationary throughout the day incurring hours of continuous downtime. To utilise the aircraft and reduce downtime, an additional, commercial service could be offered; for example, Cardiff–Paris – taking advantage this downtime with the assistance of operating aid.”⁸⁰

82. The Committee believes that the restrictions with RAF Valley were not properly considered at the time it was chosen to be the North Wales destination, as it limits the options for services on Fridays and cannot accommodate either a weekend service for any variation in the operating hours. This appears to be a missed opportunity for flexibility in the future.

83. For example, the Director General suggested that:

“A less good option, which still might be commercial, that some operators have suggested is to do the existing service, then fly back up to Hawarden and then fly back again. The fuel cost of this type of activity is not as big as you might imagine.”⁸¹

84. The Committee notes that there a number of interrelated issues with the current location of the Air Service in North Wales such as the military restrictions, potential size for any aircraft which can land at RAF Valley, the flying times and days. We would however like to see further exploration of ways to maximise the use of the Air Service. Given the additional flexibility recently added to PSO rules, it appears very uneconomical for the aircraft to be sitting idle for the majority of the day, and therefore we believe that consideration should be given to scheduling additional flights to additional locations during the day.

⁸⁰ Written Evidence, PAC(4)-16-14 (paper 12), 12 June 2014

⁸¹ Record of Proceedings, 25 March 2014, paragraph 81

The Committee recommends that, given the new flexibility under the Public Service Obligation rules, the Welsh Government explores possible options to maximise the benefits and opportunities presented by the Air Service in the future.

Witnesses

The following witnesses provided oral evidence to the Committee on the dates noted below. Transcripts of all oral evidence sessions can be viewed in full at

www.senedd.assemblywales.org/mgIssueHistoryHome.aspx?Id=1311

Tuesday 25 March 2014

James Price	Director General - Business, Enterprise, Technology & Science, Welsh Government
Mal Drury	Head of Rail/Air Commitments Operations, Welsh Government
Gareth Morgan	Deputy Director, Delivery, Welsh Government
Martin Evans	Visiting Fellow - Faculty of Business and Society, University of South Wales

List of written evidence

The following people and organisations provided written evidence to the Committee. All written evidence can be viewed in full at

www.senedd.assemblywales.org/ieIssueDetails.aspx?Id=8697&Opt=3

<i>Organisation</i>	<i>Reference</i>
Wales Audit Office Memorandum	PAC(4)-02-14 (paper 4)
James Price, Director General - Business, Enterprise, Technology & Science, Welsh Government	PAC(4)-09-14 (paper 1)
Martin Evans, Visiting Fellow - Faculty of Business and Society, University of South Wales	PAC(4)-09-14 (paper 2)
James Price, Director General - Business, Enterprise, Technology & Science, Welsh Government	PAC(4)-11-14(paper 4)
James Price, Director General - Business, Enterprise, Technology & Science, Welsh Government	PAC(4)-16-14(paper 12)