

Subsidy Advice Unit Report on a proposed subsidy to Loganair Limited

Referred by Dundee City Council

25 October 2023

Subsidy Advice Unit

Part of the Competition and Markets Authority

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1. Introduction

- 1.1 This report contains an evaluation prepared by the Subsidy Advice Unit (SAU), part of the Competition and Markets Authority, under section 59 of the Subsidy Control Act 2022 (the Act).
- 1.2 The SAU has evaluated Dundee City Council's assessment of compliance with the requirements of Chapters 1 and 2 of Part 2 of the Act (the Assessment) in relation to a proposed subsidy to Loganair Limited (Loganair) for the provision of air services between Dundee and London.¹
- 1.3 This report is based on the information provided to the SAU by Dundee City Council in its Assessment and evidence submitted relevant to that Assessment.
- 1.4 This report is provided as non-binding advice to Dundee City Council. The purpose of the SAU's report is not to make a recommendation on whether the subsidy should be given, nor to directly assess whether it complies with the subsidy control requirements. Dundee City Council is ultimately responsible for granting the subsidy based on its own Assessment, having the benefit of the SAU's evaluation.
- 1.5 A summary of our observations is set out at section 2 of this report.

The referred subsidy

- 1.6 Dundee City Council is seeking to award a subsidy to Loganair to provide a scheduled air service between Dundee Airport and a London airport. The policy objective of the subsidy is to maintain a commercial air route between Dundee and London in order to provide the economic and social benefits that would arise from it.
- 1.7 This subsidy relates to the imposition of an exclusive Public Service Obligation (PSO) on the route under retained EU regulation.² Further background information on PSOs is set out in paragraph 1.11.
- 1.8 A PSO for Dundee – London services has operated since 2014. The current PSO, operated by Loganair, has run from October 2019 to October 2023 and currently flies to and from London Heathrow. The anticipated start date for the new PSO contract is 30 October 2023, for a period of two years with the option to extend twice, at Dundee City Council's sole discretion, for a further period of one year.

¹ Chapter 1 of Part 2 of the Act requires a public authority to consider the subsidy control principles and, where applicable, the energy and environment principles before deciding to give a subsidy. The public authority must not award the subsidy unless it is of the view that it is consistent with those principles. Chapter 2 of Part 2 of the Act prohibits the giving of certain kinds of subsidies and, in relation to certain other categories of subsidy creates a number of requirements with which public authorities must comply.

² Regulation (EC) No. 1008/2008 of the European Parliament and of the Council of 24th September on common rules for the operation of air services in the United Kingdom.

The Subsidy referred to the SAU might therefore run for a total of four years. The PSO route will be funded by the Department for Transport (DfT), Transport Scotland and Dundee City Council. The subsidy will be paid to Loganair by Dundee City Council.

- 1.9 The contract for the route operation between Dundee Airport and London has been tendered by Dundee City Council through an open public procurement process. Under the contractual terms for the tender, tenderers were requested to submit bids based on a minimum 11 return flights per week from Dundee Airport to a London airport, with two daily return flights on weekdays. Loganair was the only tenderer.
- 1.10 Dundee City Council submitted that the total subsidy committed for the next two years from October 2023 to October 2025 is a maximum of £6,216,255, and that the PSO represents an ongoing subsidy meeting day to day costs.

Background on the imposition of PSOs

- 1.11 Dundee City Council submitted that retained EU law (Article 16, EC Regulation 1008/2008) enables the Secretary of State at the DfT to impose a PSO in respect of scheduled air services between an airport in the UK or Gibraltar and an airport serving either a peripheral or development region of the UK or Gibraltar, or on a thin route to any airport in the UK or Gibraltar, where the route is considered vital for the economic and social development of the region which the airport serves.³ Dundee City Council noted that:
- (a) That obligation is to be imposed only to the extent necessary to ensure on the route the minimum provision of scheduled air services satisfying fixed standards of continuity, regularity, pricing or minimum capacity which air carriers would not assume if they were solely considering their own commercial interest.
 - (b) Article 16(9) of the retained EU regulation provides that if no air carrier has commenced or can demonstrate that it is about to commence sustainable scheduled air services on a route, then the Secretary of State may grant an exclusive PSO for a period of up to four years, after which the situation shall be reviewed. Where an exclusive PSO is imposed, then it must be granted through a public tender (in line with Article 17 of retained EU regulation).

³ The DfT [Guidance on the Protection of Regional Air Access to London \(2013\)](#) identifies three tests which need to be met for the imposition of a PSO (the PSO tests). These tests seek to establish i) whether the route serves a development or peripheral region or can be classified as a thin route (fewer than 50,000 passengers per annum); ii) whether the route is vital for economic and social development; and, iii) whether the imposition of a PSO would result in adequate provision of services to meet the needs of users to maximise the impact of the service.

- (c) A case for a PSO must be made by the granting authority to DfT. The process for PSO applications is described in the Guidance on the Protection of Regional Air Access to London.⁴

SAU referral process

- 1.12 On 8 September 2023 Dundee City Council requested a report from the SAU in relation to the proposed subsidy to Loganair. The request was made on behalf of Dundee City Council, DfT and Transport Scotland.
- 1.13 In supporting evidence Dundee City Council explained that Loganair has previously operated the PSO from October 2019 to October 2023 for which it received a related subsidy which, when combined with the proposed subsidy for the period October 2023 to October 2025, will exceed the £10m threshold and qualify the proposed support as a Subsidy of Particular Interest.⁵
- 1.14 The SAU notified Dundee City Council on 14 September 2023 that it would prepare and publish a report within 30 working days (ie on or before 25 October 2023).
- 1.15 The SAU published details of the referral on 15 September 2023.⁶ The SAU received one submission from a stakeholder in relation to the referred subsidy.

⁴ See [Guidance on the Protection of Regional Air Access to London \(2013\)](#).

⁵ See cumulation rules in [Statutory Guidance](#) (paragraphs 10.35 to 10.43).

⁶ SAU [Referral Webpage](#).

2. Summary of the SAU's observations

- 2.1 The Assessment is drafted in line with the four-step process described in the Statutory Guidance for the United Kingdom Subsidy Control Regime (the [Statutory Guidance](#)) and as reflected in the SAU's Guidance on the operation of the subsidy control functions of the Subsidy Advice Unit (the [SAU Guidance](#)).
- 2.2 Overall, we consider that the Assessment broadly covers the subsidy control principles outlined in the Act (the Principles). The decision to provide the subsidy is related to the imposition of a PSO on the Dundee to London route. For its PSO application and funding proposal, Dundee City Council has prepared an economic case that has been reviewed by Transport Scotland and DfT. We recognise that documentation related to the PSO process is likely to be relevant to the assessment against the Principles.
- 2.3 However, Dundee City Council could have better considered the interplay between the PSO criteria and the Principles in order to further explain and evidence in the Assessment the subsidy's compliance with the Principles. Dundee City Council could have structured its Assessment more directly to reflect the Statutory Guidance rather than relying on the criteria set out for the PSO case, in particular where the PSO tests do not correlate, or correlate only partially, with the Principles. There are some instances where Dundee City Council provided only limited information and evidence to support its assertions, or where it did not reference the relevant evidence clearly. To strengthen its Assessment, Dundee City Council could have included more information and supporting material that formed part of the PSO application and review process, where such information and material could be useful to support specific aspects of the Principles.
- 2.4 More specifically, to be improved, the Assessment could:
- (a) In relation to Principle A, better structure the market failure and equity rationale to more closely follow the Statutory Guidance rather than the PSO tests.
 - (b) In relation to Principle D, explaining and evidencing more clearly the view that the subsidy is compensating for costs that would have been funded absent the subsidy.⁷ In our view, where a subsidy addresses a viability gap to ensure the provision of a service that would not otherwise be provided, this would indicate that the 'additionality' requirement described in the Statutory Guidance is met and that the subsidy is, therefore, consistent with Principle D.

⁷ The Assessment implies that Dundee City Council considers that it can proceed with the subsidy given the service's status as a Services of Public Economic Interest (SPEI), even if it is not consistent with Principle D, see [Statutory Guidance](#), paragraph 6.18.

- (c) In relation to Principle B, describe in more detail the work done to assess whether the size of the subsidy is the minimum amount necessary to achieve the specific policy objective and more clearly explain what evidence has been relied upon to verify proportionality relative to the policy objectives.
- (d) In relation to Principle F, give fuller consideration to alternatives to the air route (particularly air travel from Edinburgh) and how these might be affected, to assess more comprehensively the possible distortive effects of the subsidy.

2.5 Our report is advisory only and does not directly assess whether the subsidy complies with the subsidy control requirements, nor is its purpose to make a recommendation on whether the subsidy should be given. We have not considered it necessary to provide any advice about how the proposed subsidy may be modified to ensure compliance with the subsidy control requirements.⁸

⁸ Section 59(3)(b) of the Act.

3. The SAU's Evaluation

3.1 This section sets out our evaluation of the Assessment, following the four-step framework structure used by Dundee City Council.

Step 1: Identifying the policy objective, ensuring it addresses a market failure or equity concern, and determining whether a subsidy is the right tool to use

3.2 The first step involves an evaluation of the Assessment against:

- (a) Principle A: Subsidies should pursue a specific policy objective in order to remedy an identified market failure or address an equity rationale (such as local or regional disadvantage, social difficulties or distributional concerns); and
- (b) Principle E: Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other, less distortive, means.⁹

Policy objectives

3.3 The Assessment states that the primary policy objective is to maintain a commercial air route between Dundee and London in order to provide the economic and social benefits that would arise from it. The subsidy supports the provision of a new PSO on that route for the period 30 October 2023 to 29 October 2025 (with a possibility for two one-year extensions). It sets out background information on how a PSO may be imposed under retained EU law which may provide for support for scheduled air services where that support is considered vital for the economic and social development of the region which the airport serves (see paragraph 1.11).

3.4 The Assessment goes on to set the policy objective in the broader context of the ambitions of the Tay Cities Region, City of Dundee and airport as referenced in the Tay Cities Region Economic Strategy (2019-2039)¹⁰ and the TACTRAN Regional Transport Strategy (2015-2036).¹¹ In these documents, local partners detail plans to enhance connectivity directly to the region to support economic growth in key economic sectors¹² such as inbound tourism and export related businesses. This

⁹ Further information about the Principles A and E can be found in the [Statutory Guidance](#) (paragraphs 3.18 to 3.42) and the [SAU Guidance](#) (paragraphs 4.7 to 4.11).

¹⁰ [Tay Cities Region Economic Strategy 2019-2039, Tay Cities Deal](#).

¹¹ Tayside and Central Scotland Transport Partnership (Tactran) - See [Regional Transport Strategy](#).

¹² The Tay Cities Region Economic Strategy 2019-2039 p13 highlights Tourism; Food and Drink; Engineering and Manufacturing; Energy and Renewables; Digital and Creative Industries (including Digital) as examples of key growth sectors for the regional economy.

includes supporting investment in infrastructure related to the airport as well as improvements in regional connectivity.

- 3.5 We consider that the Assessment demonstrates a coherent policy objective and helpfully sets the context of the PSO, linking this to the achievement of broader regional economic and transport strategy objectives.

Market failure and equity objective

- 3.6 The Statutory Guidance sets out that:
- (a) Market failure occurs where market forces alone do not produce an efficient outcome.¹³
 - (b) Equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.¹⁴
- 3.7 The Assessment presents evidence of how the subsidy meets one of the PSO tests, related to whether the route serves a development or peripheral region or a thin route, to demonstrate both a market failure and equity rationale under the Principles. In the evidence provided in support of the Assessment, Dundee City Council also explained that the range of economic benefits and wider investment unlocked by the subsidy is evidence of market failure and an equity rationale.
- 3.8 The market failure rationale is described in the context of the classification of the Dundee to London route as a thin route in line with the PSO guidelines. However, while this is relevant context, this could mistakenly confuse an assessment of the financial viability of the route with market failure. We consider that the market failure rationale would be strengthened if the evidence presented was structured more directly to reflect the Principles set out within the Statutory Guidance. Dundee City Council could have considered evidence of potential positive externalities associated with wider economic and social benefits (eg where air connectivity supports the region's tourism and export related businesses, but these are not internalised by the operator, or where air connectivity provided by the PSO helps support regional projects).
- 3.9 The Assessment goes on to describe the PSO test linked to whether the route serves a development or a peripheral region as an indicator of equity (and market failure) rationale.
- 3.10 We consider that the nature of the PSO and the proposed subsidy would suggest equity grounds as a strong rationale for intervention. The Assessment cites Dundee and its area's previous status as a development region under the EU's

¹³ [Statutory Guidance](#), paragraphs 3.21 to 3.32.

¹⁴ [Statutory Guidance](#), paragraphs 3.35 to 3.39.

Assisted Areas map, as well as the area's eligibility for regional development funding under UK successor programmes based on indicators of need and deprivation, as evidence of its status as a development region for the purposes of the PSO test. The Assessment also presents data on relative economic performance and key economic indicators linked to gross value added, employment, business start-ups and journey times between Dundee and central London as further evidence of relative economic underperformance justifying support. In our view the equity rationale would be stronger if the evidence presented was structured more directly to reflect the Principles set out within the Guidance, for example, by setting out more clearly how the policy objective will help address the equity concerns identified.

Consideration of alternative policy options and why the subsidy is the most appropriate and least distortive instrument

- 3.11 In order to comply with Principle E, public authorities should consider why the decision to give a subsidy is the most appropriate instrument for addressing the identified policy objective, and why other means are not appropriate for achieving the identified policy objective.¹⁵
- 3.12 The Assessment focuses on whether the subsidy is the best instrument to achieve the policy objective narrowly defined as the support of a commercial air route between Dundee and London. It relies on the PSO mechanism to support the case for intervention and explains that a PSO is a well-established mechanism to deliver the desired policy objective to maintain a commercial air route in order to provide the economic and social benefits that would arise from it. The Assessment acknowledges that there may be other ways to stimulate the local economy but states that they would not be as focused or effective as a commercial air route between Dundee and London. It also highlights that a loan on commercial terms would not incentivise an airline to provide the service at a likely loss.
- 3.13 However, we consider that the Assessment could have been strengthened if it had better explained how the subsidy is the most appropriate instrument to achieve regional plans to enhance connectivity directly to the region, including to support economic growth in key areas such as inbound tourism and export related businesses. Whilst the Assessment acknowledges that there may be other ways to stimulate the local economy, it does not set out what these are, and why they were discounted.

¹⁵ [Statutory Guidance](#), paragraphs 3.40 and 3.41.

Step 2: Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change

3.14 The second step involves an evaluation of the Assessment against:

- (a) Principle C: First, subsidies should be designed to bring about a change of economic behaviour of the beneficiary. Second, that change, in relation to a subsidy, should be conducive to achieving its specific policy objective, and something that would not happen without the subsidy; and
- (b) Principle D: Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.¹⁶

Counterfactual assessment

3.15 In assessing the counterfactual, the Statutory Guidance explains that public authorities should assess any change against a baseline of what would happen in the absence of the subsidy (the 'do nothing' scenario).¹⁷ This baseline would not necessarily be the current 'as is' situation (the 'status quo') but what would likely happen in the future – over both the long and short term – if no subsidy were awarded.

3.16 The Assessment describes a counterfactual whereby:

- (a) the Dundee to London route will cease to operate;
- (b) the aircraft will no longer be based at Dundee Airport; and
- (c) the knock-on impact will be that other routes will likely cease.

3.17 We find that the Assessment clearly asserts that, without the subsidy, it would not be economically viable for a carrier to operate the route.

3.18 We consider that the Assessment could be improved by setting out in more detail the basis for concluding that the route would cease to operate, by referencing the supporting material from the PSO application and review by Transport Scotland and DfT insofar as it is relevant.

¹⁶ Further information about the Principles C and D can be found in the [Statutory Guidance](#) (paragraphs 3.43 to 3.57) and the [SAU Guidance](#) (paragraphs 4.12 to 4.14).

¹⁷ [Statutory Guidance](#), paragraphs 3.46 and 3.47.

Changes in economic behaviour of the beneficiary

- 3.19 The Statutory Guidance sets out that subsidies must bring about something that would not have occurred without the subsidy.¹⁸ In demonstrating this, public authorities should consider the likely change or additional net benefit.
- 3.20 The Assessment states that ‘Awarding this subsidy as a PSO enables Loganair to change its behaviour to provide a service which it would not typically provide.’
- 3.21 We find that the Assessment clearly describes the change of economic behaviour which would occur if the viability gap were met and how it is conducive to achieving the policy objective, in that the subsidy is designed to create the right economic incentives for the carrier to operate a route between Dundee and London which it would not operate under the counterfactual.

Additionality assessment

- 3.22 According to the Statutory Guidance, ‘additionality’ means that subsidies should not be used to finance a project or activity that the beneficiary would have undertaken in a similar form, manner, and timeframe without the subsidy.¹⁹
- 3.23 Dundee City Council told us that the subsidy is not consistent with Principle D which requires that subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy. The Assessment also refers to section 29(8) of the Act which provides that, in relation to Services of Public Economic Interest (SPEI),²⁰ the duties in section 12(1) of the Act apply only so far as they do not obstruct the carrying out of those services. Those duties include the duty not to give a subsidy unless it is considered consistent with the Principles. The Assessment states that, if the subsidy were unable to be awarded on the basis that it would be inconsistent with Principle D, then the PSO service could not be operated. The Assessment implies that Dundee City Council considers that it can proceed with the subsidy given the service’s SPEI status, even if it is not consistent with Principle D.²¹
- 3.24 In relation to Principle D, we find that the Assessment could be improved by explaining and evidencing more clearly Dundee City Council’s view that the subsidy is compensating for costs that would have been funded absent the subsidy.
- 3.25 In our view, where a subsidy addresses a viability gap to ensure the provision of a service that would not otherwise be provided, this would indicate that the

¹⁸ [Statutory Guidance](#), paragraph 3.50.

¹⁹ [Statutory Guidance](#), paragraphs 3.49 to 3.53.

²⁰ Dundee City Council has identified that the subsidy would engage section 29 of the Act because it involves the delivery of a SPEI. See paragraphs 3.50 to 3.55.

²¹ See [Statutory Guidance](#), paragraph 6.18.

'additionality' requirement described in the Statutory Guidance is met and that the subsidy is, therefore, consistent with Principle D.

Step 3: Considering the distortive impacts that the subsidy may have and keeping them as low as possible

3.26 The third step involves an evaluation of the Assessment against:

- (a) Principle B: Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it; and
- (b) Principle F: Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the UK.²²

Proportionality

Limited to what is necessary

3.27 The Statutory Guidance states that a competitive allocation process for a subsidy can help public authorities to meet Principle B.²³

3.28 The Assessment explains that the subsidy is consistent with Principle B, referring to the use of a competitive allocation process and elements relating to the design of the subsidy (such as its size relative to overall costs, timespan, performance criteria and ringfencing). Further, the Assessment states that the economic case has been prepared by Dundee City Council, and reviewed by Transport Scotland and DfT.

3.29 Following a request for information from the SAU, Dundee City Council provided a copy of a contractual agreement which it is proposing to enter into with Loganair. This agreement includes information which was not provided in the Assessment relating to how the size of the periodic payments of subsidy is calculated. The contractual agreement states that the amount of the subsidy payments per period shall be the lower of:

- (a) the sum specified in the carrier's tender bid, or another sum which may be agreed between Dundee City Council and the carrier; and
- (b) the carrier's deficit in operating the route.

²² Further information about the Principles B and F can be found in the [Statutory Guidance](#) (paragraphs 3.58 to 3.93) and the [SAU Guidance](#) (paragraphs 4.15 to 4.19).

²³ [Statutory Guidance](#), paragraphs 3.70.

- 3.30 It also notes the use of open book accounting enabling checking that costs incurred are specific to the route and revenues, and that there would be opportunities to review the route's performance, including when deciding whether to extend the duration of the subsidy.²⁴
- 3.31 In our view, Dundee City Council clearly describes in the Assessment and response to a clarification question its conclusion that the subsidy is consistent with Principle B. We were provided with details of the subsidy agreement which provides further useful information on how the periodic payments of the subsidy are calculated. There are aspects of the design of the subsidy that help ensure it is proportionate to the policy objectives and limited to what is necessary. These include that there was a competitive tender, and that actual subsidy payments are capped and will vary with costs incurred and revenues achieved on the route. However, this could have been better described in the Assessment.
- 3.32 First, we consider that the Assessment could be strengthened by describing how the receipt of only one tender bid in the competitive allocation process was taken into account in considering Principle B.
- 3.33 Second, the Assessment could also be strengthened by describing in more detail how Loganair's forecasts were 'triangulated and crosschecked for reasonableness' using analytical procedures. For example, it could set out in more detail whether:
- (a) Any negotiations over the size of the subsidy have taken place with Loganair since it was a single bidder and, if so, what the outcome of these negotiations has been.
 - (b) Dundee City Council, Transport Scotland or DfT conducted any benchmarking of Loganair's financial forecasts against the profitability of operating similar routes elsewhere.
 - (c) The size of the subsidy is broadly consistent with the size of the previous subsidy for operating the same route, taking into account changes in key underlying factors such as operating costs, the number of passengers²⁵ and the London terminus changing from London City to Heathrow.

Proportionate to the specific policy objective

- 3.34 The Assessment, in considering whether the subsidy is proportionate to the specific policy objective, refers to the second and third PSO tests. It states that these:

²⁴ We received a response from a third party noting that the amount of the subsidy should be able to be changed if the ownership of Loganair changes and the purchaser has a lower cost base or benefits from better economies of scale.

²⁵ Annual passenger numbers are expected to increase from around 20,000 at the time the previous subsidy was granted to around 40,000 under the proposed subsidy.

- (a) 'require the public authority to demonstrate that the imposition of a PSO should include adequate provision of services to meet the needs of users to maximise the impact of the service' (test 3); and
- (b) 'highlight that there must be a proportionality between the necessity and adequacy of the proposed service, and the economic needs of the region' (test 2).

3.35 We observe that whilst there may be some read across between these PSO tests and the Principles, the Assessment could benefit from explaining in more detail the relevance of the assessment of tests 2 and 3 to Principle B.

3.36 In our view, the Assessment could be improved by explaining in more detail what evidence has been considered to assess Principle B. For example, the Assessment could refer to the economic case prepared by Dundee City Council, and evidence from DfT and Transport Scotland's review of it, insofar as this evidence is relevant to assessing whether the size of the subsidy is proportionate to its policy objective.

Design of subsidy to minimise negative effects on competition and investment

3.37 The Assessment covers aspects of subsidy design as set out in paragraphs 3.28 to 3.30. It is noted that the subsidy will be used to meet day-to-day costs and this is recognised as potentially negatively impacting competition but that the risk is minimised, for example by restricting the use of funds to this route only.

3.38 We consider that the Assessment covers the key elements of subsidy design as set out in Step 3 and Annex 2 of the Statutory Guidance. In our view, the Assessment could have further demonstrated how the subsidy's potentially negative impacts on competition and investment have been minimised by explaining the details of the criteria for awarding an extension. Providing recurring subsidies over a period of time is likely to have a greater distortive impact as it risks funding continuing when it is no longer needed, or deterring new entrants to the market.²⁶ Periodic review of ongoing subsidies can mitigate this, as is planned by Dundee City Council after two years. However, the Assessment could include detail of what the review will cover, for example, consideration of any changes in market conditions.

²⁶ See [Statutory Guidance](#) (paragraphs 3.81 and 3.90).

Assessment of effects on competition or investment

- 3.39 The Assessment recognises under Step 4 that the subsidy risks a negative effect on competition in the UK or internationally, but that this has been minimised by some of the subsidy's design features (see paragraph 3.28).
- 3.40 The Assessment identifies flights between Edinburgh and London as a potential alternative to the subsidised route, but these are discounted on the basis that the journey time to Edinburgh airport from Dundee exceeds 60 minutes by all modes of travel.²⁷ Air travel from Aberdeen is also discounted based on distance and travel time. It is explained that no other carrier has indicated willingness to operate the route on a commercial basis and at the frequency required.
- 3.41 In terms of understanding the size of the subsidy relative to the market, the Assessment explains that travel via the subsidised route represented a very small proportion of the total number of passengers travelling to or from the Tay Cities region in 2018.²⁸
- 3.42 In our view, whilst it might be reasonable to conclude that the overall impact on competition and investment is likely to be relatively small given the size of the subsidy and market characteristics, this could be better evidenced in the Assessment, including through engagement with relevant sections of the Analytical Framework chapter of the SAU Guidance.²⁹ Evidence could be included on the characteristics of the market that will be affected by the subsidy. As set out in Annex 2 of the Statutory Guidance, a carefully delineated market should comprise the most important competitive alternatives to the services affected by the subsidy.³⁰ Whilst we appreciate the use of existing airport catchment area definitions, to strengthen the Assessment it would be appropriate to consider:
- (a) Air travel between Edinburgh and London, given Edinburgh airport is close to meeting the criteria to fall within Dundee airport's catchment area, and that the majority of air travellers in the Tay Cities region use it.³¹ Other nearby airports with routes to London could also be considered, given the scope of the subsidised route.
 - (b) Rail travel between Dundee and London as a possible viable alternative. Whilst we recognise that the PSO criteria define a region as peripheral if the total journey time to London by public surface transport is more than three

²⁷ The catchment area definition used in the Assessment is 100km or around 60 minutes travel time, on the basis that this has previously been accepted by the European Commission in relation to PSOs, and that 100km has been used as criteria for the Regional Connectivity Fund.

²⁸ For a more direct comparison of the size of the subsidy relative to the market, where available, the Assessment could have included the share of passengers travelling to and from London specifically that use Dundee airport. and could have provided developments in passenger numbers over time.

²⁹ See [SAU Guidance](#) (paragraphs 4.18 and 4.19)

³⁰ See [Statutory Guidance](#) (Annex 2, paragraph 16.32).

³¹ Elsewhere in the assessment, it is noted that Edinburgh Airport was the most used airport for passengers travelling to or from the Tay Cities Region in 2018.

hours,³² this does not necessarily preclude it from being a viable alternative for consumers and therefore exerting a competitive constraint on the subsidised route.

- (c) Differentiation between business and leisure travellers, whose time sensitivity is likely to vary and may affect the catchment area of the airport and therefore the competitive effects.³³ Such differentiation is likely to be important given the subsidy's intended focus on supporting business travel.

3.43 Such examination of what consumers might regard as substitutes to the air route could allow for a more comprehensive assessment of the subsidy's competitive impacts (including the nature and scale of the effects) relative to how individuals might respond under the counterfactual of route closure (ie that some people would not travel whilst others would use alternative modes of transport or airports).

Step 4: Carrying out the balancing exercise

3.44 The fourth step involves an evaluation of the assessment against subsidy control Principle G: subsidies' beneficial effects (in terms of achieving their specific policy objective) should outweigh any negative effects, including in particular negative effects on: (a) competition or investment within the UK; (b) international trade or investment.³⁴

3.45 The Assessment refers to the Economic Impact Assessment undertaken by a specialist aviation consultancy in April 2023, that found that the subsidy will provide significant economic benefit each year, including direct economic benefits and indirect effects on business productivity and inbound tourism. It finds a positive benefit to cost ratio.

3.46 Dundee City Council accepts that there is a risk of the subsidy giving rise to a negative effect on competition in the UK or internationally. Whilst Loganair will have exclusivity, no other carrier has indicated they are willing to operate the route on a commercial basis and at the frequency required, limiting the impact on competition. It further sets out that the impact will be minimised because of mitigating factors, also set out in relation to proportionality (see paragraphs 3.27 to 3.363.36).

3.47 Finally, the Assessment states that the subsidy will not have a significant effect on international trade or investment.

³² See [Guidance on the Protection of Regional Air Access to London, Department for Transport](#), paragraph 42.

³³ A set out in the SAU guidance, public authorities may wish to rely on published reports by competition or regulatory authorities relating to relevant markets (or similar markets). In this case, [Ex post assessment of the impact of state aid on competition, European Commission, 2017](#), chapter 3 could provide a helpful framework for considering the competitive effects of subsidising air travel, including differentiating between travellers.

³⁴ See [Statutory Guidance](#) (paragraphs 3.96 to 3.98) and [SAU Guidance](#) (paragraphs 4.20 to 4.22) for further detail.

- 3.48 We consider that the Assessment helpfully sets out some of the positive impacts against the policy objectives and provides useful supporting documentation in support of the cost / benefits modelling. On some aspects, the Assessment could be clearer, for instance it is not explained whether the inbound tourism benefits would shift spending from other areas.
- 3.49 Further to the points made about the competitive assessment under Step 3, the balancing exercise could more closely adhere to the Statutory Guidance and include relevant evidence from evaluation of the existing PSO subsidy if available. In addition, the Assessment could be improved by:
- (a) setting out the potential impact on the environment associated with an air service between Dundee and London relative to the counterfactual. The balancing exercise requires all relevant negative effects to be weighed up against the benefits of the subsidy (see paragraph 3.100 of the Statutory Guidance). This would include the existence of relevant effects regarding energy or the environment; and
 - (b) considering the extent to which the subsidy contributes to the achievement of its broader economic and social development objectives, taking account of whether travellers would respond to the route ceasing by making alternative arrangements or not travelling at all.

Other Requirements of the Act

- 3.50 This step in the evaluation relates to the requirements and prohibitions set out in Chapter 2 of Part 2 of the Act, where these are applicable.³⁵
- 3.51 Dundee City Council has identified that the subsidy would engage Section 28 of the Act as it is a subsidy to an air carrier for the operation of routes, and Section 29 of the Act because it involves the delivery of a SPEI.
- 3.52 Section 28 of the Act sets out that a subsidy to an air carrier for the operation of a route is prohibited unless the conditions in subsection (2), (3) or (4) is met. The condition under subsection 2 relates to the route being operated under a PSO. As a result, Dundee City Council has concluded that an exemption applies in relation to the prohibition under Section 28.
- 3.53 Section 29 of the Act include the following requirements:
- (a) the subsidy is limited to what is necessary to deliver the SPEI services having regard to costs of delivery and reasonable profits;³⁶

³⁵ [Statutory Guidance](#), chapter 5.

³⁶ Section 29(2) of the Act.

- (b) the subsidy is given in a transparent manner, meaning that the subsidy is given in accordance with a written contract (or other legally enforceable arrangement in writing), which sets out the terms of the subsidy and contains certain prescribed information;³⁷ and
- (c) arrangements are in place to regularly review the subsidy to ensure it remains limited to the minimum amount necessary and that any excess funds can be recovered.³⁸

3.54 Dundee City Council has set out that:

- (a) In relation to Section 29 (2), the contract terms restrict the use of the subsidy to only cover costs defined in the tender response and does not allow unused funds to be used for any other purpose by the supplier.
- (b) In relation to Section 29 (3) and (5), the subsidy will be given in a transparent manner and the contract with the beneficiary will set out the terms of the subsidy and the information prescribed by the Act.

3.55 Whilst Dundee City Council has not explicitly addressed how Section 29 (6) of the Act is met, we consider that this is addressed elsewhere in the Assessment. Other aspects of Section 29 have been covered in the Assessment.

³⁷ Section 29(3) – (5) of the Act.

³⁸ Section 29(6) of the Act.