




Study on the practice of Public Service Obligations in Europe

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Introduction

Dr Romano Pagliari SFHEA FRAeS

Senior Lecturer in Air Transport &

Deputy Director of Research (Research Students) in SATM, Cranfield University



Aviation plays a vital role in connecting communities and citizens across the European Union (EU). It is particularly important where there is no good alternative means of connectivity, for example linking remote regions and islands to larger cities and ensuring freedom of movement for all European citizens.

Many of these 'essential connectivity' routes are not commercially viable on a standalone basis, but are justified by their socio-economic role, and are therefore financially supported by EU Member States under the Public Service Obligation (PSO) instrument. The PSO instrument plays an important role in connecting communities across the European Union, facilitating mobility and supporting regional social and economic development. Without it, air service connections would be lost, leading to airport closures, and with communities highly dependent on air services suffering considerable economic and social consequences.

Regional airlines who operate PSOs work as partners with the public authorities that manage and finance PSO routes and play an important role in delivering safe and reliable air services linking remote communities with their respective regional and national centres. Public authorities' successful and cost-effective management of PSOs depends on their ability to elicit sufficient interest in and response to invitations to tender from as many eligible air carriers as possible. Competition is important in delivering choice and also value for money for public authorities and taxpayers.

Public authorities need to appreciate that a successful PSO tendering process, built on eliciting sufficient interest from regional airlines, is largely dependent on offering realistic contract conditions. This means ensuring that contract conditions are flexible and recognise the specific economic and technical challenges involved in operating air services, particularly in smaller, low-density markets where costs are high compared to network and low-cost carriers, and where resources and assets, such as staff and aircraft, are in relatively short supply. Here we can draw inspiration from academic researchers who, based on an earlier pan-EU survey of tendering authorities, argued for reform of the PSO framework to allow for greater flexibility and, crucially, for incentivising increased passenger numbers, thereby enabling a transition from subsidised PSOs to non-subsidised fully commercial operations.¹

PSOs rightly carry important obligations to ensure safe, regular and affordable air services. Regional airlines can offer solutions to regions tendering PSO contracts, but they can only participate and add value if risks are managed, and if they are adequately remunerated for the services that are supplied.

In an environment of heightened volatility and risk, as experienced with the recent COVID-19 pandemic and with growing geopolitical tensions across Europe, it is imperative that PSO contracts are flexible, enabling regional airline partners to exercise the ability to be agile and responsive to changing circumstances. This includes the assurance that comes with having provisions in place to continue operating and financing PSOs where traffic has been impacted by a significant and unexpected event.

The climate crisis imposes a need for all sectors of our economy to decarbonise, and the airline industry is no exception. ERA, along with other aviation trade associations, has committed to reaching net-zero carbon emissions by 2050. This imperative to achieve net zero points to a need to re-evaluate the existing PSO framework to ensure operators have the correct incentives, such as extending contract length, to respond to PSO tenders with solutions that incorporate as many as possible new low-carbon technologies² and greater use of Sustainable Aviation Fuel (SAF). Our study, based on the views of ERA members, makes recommendations on how the PSO framework can be improved for the ultimate benefit of the communities and citizens that they serve.

¹ 'Efficient procurement of public air services – Lessons learned from European transport authorities' perspectives,' Rico Merkert & Basil O'Fee. *Transport Policy*, Volume 29, September 2013, Pages 118–25.

² For example, an operator may wish to respond to a PSO tender by proposing to acquire new electric or hydrogen-powered aircraft but cannot justify the high initial capital cost for a relatively short-duration PSO contract.

A word from EU regions



Conference of Peripheral and Maritime Regions (CPMR)'s contribution

Stavros Arnaoutakis, Governor of Crete Region and Vice President for Transport and Accessibility of the Conference of Peripheral Maritime Regions (CPMR) together with **Francesco Catte**, Senior Policy Analyst, CPMR

Regional and thin air connections are lifelines for many European regions (outermost, islands, peripheral and sparsely populated), their businesses and local communities, ensuring vital accessibility and connectivity. A critical role that extends beyond simple travel – it fuels economic growth and fosters social cohesion.

PSO routes, which are the focus of this study, have proven to be a valuable and key tool to promote and ensure air connectivity and accessibility. They foster the economic development and territorial cohesion of the regions and communities they serve by ensuring access to essential services, such as healthcare and education, as well as to the European Single Market.

The upcoming revision of the EU Air Services Regulation No. 1008/2008, governing the rules of PSOs, should therefore not overlook the inherent potential and proven track record of PSOs in reducing disparities and promoting territorial development. In this regard, the future PSO framework should ensure more flexibility to enable the creation of new routes and consider a stronger role for regional authorities, given their knowledge of the needs and socioeconomic fabric of their territories.

The decarbonisation of air transport is necessary. However, it should not jeopardise accessibility, but rather boost it by promoting sustainable air connectivity for all, in which PSOs and regional airlines will play an important role. We must not forget that there is an untapped – yet already visible – potential for regional aviation, airlines and airports. They can serve as commercial rollout and innovation and energy hubs for the application of zero-carbon technologies, ultimately leading to decarbonised air connectivity.

If the decarbonisation of air transport is our flight path, sustainable connectivity – in which PSOs will have a key role to play – for all regions, their businesses and communities, should be our final destination.

CPMR represents more than 150 regional authorities from 24 countries across Europe and beyond. Organised in Geographical Commissions, the CPMR works to ensure that a balanced territorial development is at the heart of the European Union and its policies.

Executive summary

The vast majority of the Public Service Obligations (PSOs) routes in Europe are operated by regional airlines. ERA's airline members' experience with the current framework shows that PSOs are implemented in varying ways across Europe. Although not necessarily a sign of differences in the interpretation of the rules, this study confirms that the practice of PSOs differs considerably when it comes to the different components of the PSO rules, such as resident discounts, contract periods, grouping of routes, the role of regional authorities, air ticket distribution, aircraft size requirements and accessibility for all passenger groups including passengers with reduced mobility and use of foreign languages in tender documents.

The purpose of the study is to make policy recommendations in the context of the forthcoming revision of EU 1008/2008, Air Services Regulation. ERA recommends the following policy measures:

- Additional funding and creation of new routes.
- Allocation of more powers to EU regions involved in the PSO process and decision making.
- Process improvements:
 - introduction of a harmonised selection procedure for PSO bidders at EU level, with which national authorities will have to comply;
 - PSO tenders to be issued and processed in English; and
 - more flexibility for grouping of routes.
- In times of crisis or force majeure, to allow the carrier to renegotiate the contract to ensure that it can cover its additional costs (such as increased compensation, costs arising from the implementation of new regulations, and so on).
- Ensuring that the PSO structure can facilitate airlines' investment in fleet renewal, by allowing consideration of the duration of contracts, for example, more than five years.
- Prioritise PSOs' core objective of maintaining essential connectivity and avoid environmental requirements that could jeopardise that connectivity.
- Establishing a dedicated and effective aid tool to enable public authorities to support airlines in assuming the financial risks of starting new routes, until the route becomes self-supporting.
- Adapting EU Regulation No. 261/2004 (EU261) liability for PSO routes.

Introduction

Regional aviation makes a significant contribution to Europe's economy, generating value in terms of employment and the wellbeing of the local communities it serves. In particular, regional airlines are enablers of connectivity, ensuring that many small and often remote communities are able to access important economic centres to support business formation and growth, facilitating tourism (including supporting jobs and GDP) and significantly reducing journey times for passengers.

In their day-to-day business, regional airlines are unique in providing air connectivity for citizens all year round, whatever the season. For business in the EU, the connectivity provided by regional airlines enables companies of any size across Europe (including SMEs) to fully access opportunities offered by the European Single Market. In many cases, air transport is the only convenient and regular means of access, and ERA's airline members serve communities where air transport is vital and often the only available transportation mode.

Because of geographic isolation and low population density, airlines struggle to operate commercial air services in these markets. On a fully commercial basis, if air services are operated at all, provision may be seasonal, expensive and inconvenient. Because of this, the EU, as part of its European Single Market for aviation, introduced a PSO (Public Service Obligation) instrument providing Member States (MSs) with the opportunity to grant financial compensation, that is, a subsidy to air carriers willing to operate flights on commercially unremunerative routes.

PSOs in the air transport sector are governed by the Air Services Regulation (EC 1008/2008) Articles 16 to 18 which set out general legislation for PSO routes. PSOs are implemented by MSs, sometimes with the involvement of regional and local authorities. The legislation allows for a degree of autonomy at national government level in terms of how PSO routes are implemented and administered. This enables procedures to be established by authorities that could be interpreted as particularly flexible or restrictive with regard to the procurement of airline services.

The current framework is now 16 years old, and a revision is becoming increasingly urgent to ensure the framework is adapted to allow for greater flexibility, thereby incentivising higher levels of airline participation which ultimately will benefit the communities that are served.

PSOs are a key instrument in sustaining Europe's connectivity, as these routes enable air links to be maintained between strategically important territories, guaranteeing citizens access to vital services such as healthcare, education and business opportunities. We believe that maintaining these essential routes is vital for the future viability of regional airlines and the connectivity and services they provide.



Regulatory support for regional aviation at EU level is therefore needed to preserve essential connectivity and support for Europe's regions.

A healthy and vibrant regional aviation industry is important not only through airlines' role in facilitating connectivity but as pioneers and first adopters of new aircraft technologies – especially with regard to electric and hydrogen-powered aircraft. However, the investment required is considerable and the regional segment must be supported to ensure that our strategic ambition to pioneer aviation decarbonisation can be fully realised.

Study methodology

In May 2023, ERA members met in Brussels for an interactive workshop on PSOs and thin routes to discuss with representatives of the European Commission (EC) the lessons learned from the existing regulatory framework (what works and what does not) and how to improve the framework in view of the future revision of the Air Services Regulation. The airlines shared their experience on the ground with the current framework and explored alternative incentive schemes to support thin routes that fall outside the scope of PSOs.

As a follow up to the workshop, ERA identified the need to produce a study on the practice of how PSOs are managed across jurisdictions. Our methodology is based on a survey of ERA airline members. The geographical scope of the survey is not limited to European Union MSs. Indeed, the same PSO instrument is used by Norway, through its membership of the Single Aviation Market via the European Free Trade Association (EFTA), and by the United Kingdom by virtue of the fact that it still uses the same PSO instrument inherited from its previous membership of the EU. PSOs are also used in Serbia which is also not an EU MS.

The survey was launched in October 2023 and all ERA airline members were invited to respond.

Survey sample

Airlines invited to respond to the survey were asked to answer the following questions:

- 1) Does your airline operate any PSO routes?
 - If yes, please try to answer below questions in view of your experience with PSO contracts.
 - If not, please try to answer below questions as far as you have knowledge of the procedures and the way PSO are handled in your Member State.
- 2) How many PSO routes do you operate? Of these, how many are closed/open PSO?
- 3) For PSO routes, how is compensation calculated?
- 4) Are fares capped and/or are there special discounts for residents? Please elaborate.
- 5) What is the practice in your Member State regarding the grouping of routes?
 - For example, are PSO contracts involving multiple routes (networks) tendered and intended to be operated as an integrated
- 6) With regard to the PSO contract terms & conditions, what are the minimum requirements to which you are subject (prices, frequencies, capacity, timetabling, aircraft size etc)? How are these defined?
- 7) Do you feel that PSO rules are interpreted differently from one Member State to another? If so, please provide at least one concrete example from your experience.
- 8) Do you believe that the Interpretative Guidelines adopted in 2017 have contributed to better clarify PSO rules?
- 9) Do you feel that the PSO decision process differs from one Member State to another? If yes, to what extent? Please provide concrete examples.
- 10) Does the country you operate in have a special procedure to adapt the PSO contract (e.g., in times of crisis)? Please share your experience of the COVID-19 pandemic.
- 11) In the country in which you operate, is the decision-making process for opening a PSO route entirely in the hands of the national authorities, or is there room for manoeuvre with regional/local authorities, i.e. local/regional direct support and decisions?
- 12) Do you feel that the Member State in which you operate has sufficient financial capacity and intention to assist PSO carriers in investing in new green aircraft?
- 13) Is there any possibility to receive route support from a private investor (i.e., company, group of companies, industry) in your market? If so, please describe.
- 14) Do you have knowledge of different route support schemes practised in your Member State or market? If so, please describe.

network or is it possible for airlines to respond to the tender with an offer to operate selected individual routes in the network?

Geographical scope

The following 14 ERA airlines operating PSO routes took part in the study.



List of PSO routes operated by ERA airline members participating in the study



Air Corsica operates 12 PSO routes as follows.

Eight routes alone:

1. Marseille (MRS)–Ajaccio (AJA)
2. Marseille (MRS)–Bastia (BIA)
3. Marseille (MRS)–Calvi (CLY)
4. Marseille (MRS)–Figari (FSC)
5. Nice (NCE)–Ajaccio (AJA)
6. Nice (NCE)–Bastia (BIA)
7. Nice (NCE)–Calvi (CLY)
8. Nice (NCE)–Figari (FSC)

Four routes in a joint agreement with Air France:

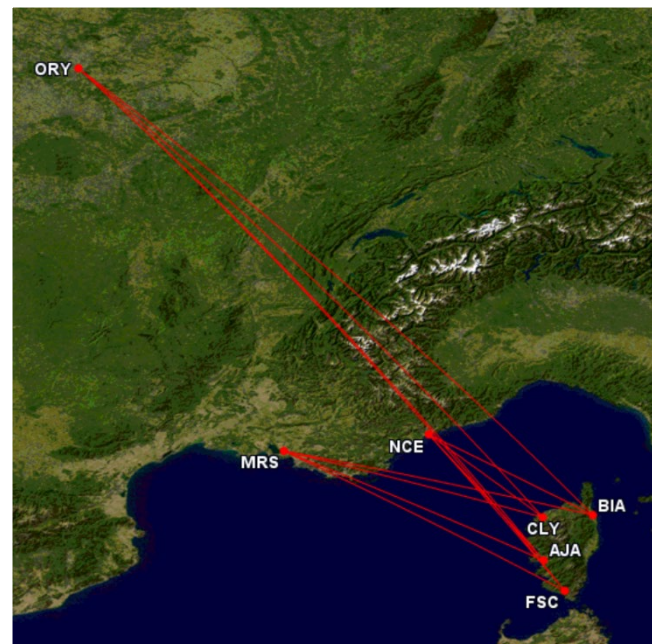
1. Paris Orly (ORY)–Ajaccio (AJA)
2. Paris Orly (ORY)–Bastia (BIA)
3. Paris Orly (ORY)–Calvi (CLY)
4. Paris Orly (ORY)–FSC

Additional information has been provided by:



These airlines represent 11 countries as shown in Figure 1 below.

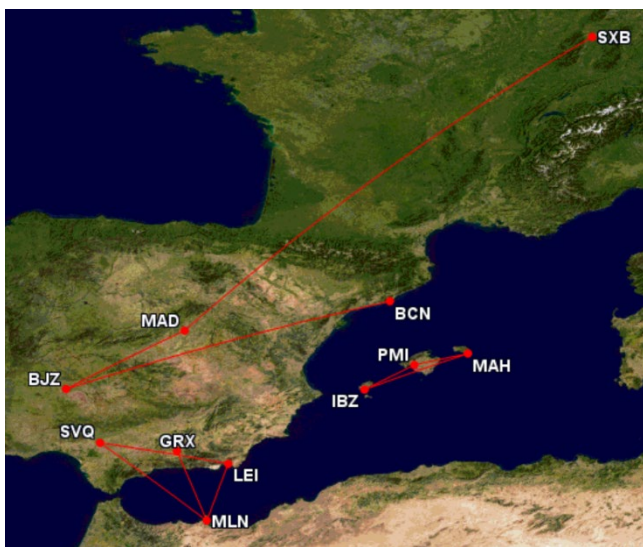
Figure 1: Geographical representation.





Air Nostrum operates the following PSO routes:

1. Palma de Mallorca (PMI)–Ibiza (IBZ)
2. Palma de Mallorca (PMI)–Menorca (MAH)
3. Ibiza (IBZ)–Menorca (MAH)
4. Almería (LEI)–Sevilla (SVQ)
5. Badajoz (BJZ)–Madrid (MAD)
6. Badajoz (BJZ)–Barcelona (BCN)
7. Melilla (MLN)–Almería (LEI)
8. Melilla (MLN)–Sevilla (SVQ)
9. Melilla (MLN)–Granada (GRX)
10. Strasbourg (SXB)–Madrid (MAD)



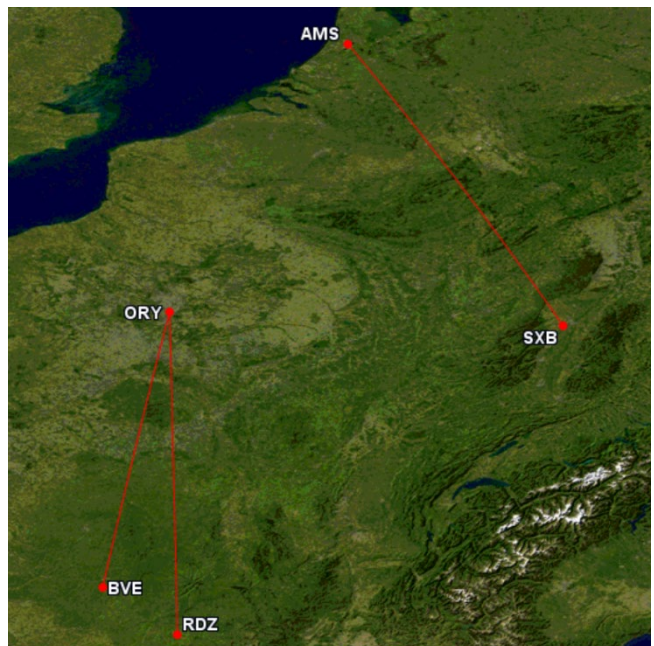
From 2022, Air Serbia operates 10 PSO routes from 2 airports from undeveloped areas of the country:

1. Nis (INI)–Belgrade (BEG)
2. Nis (INI)–Ljubljana (LJU)
3. Nis (INI)–Istanbul (IST)
4. Nis (INI)–Frankfurt-Hahn (HNN)
5. Nis (INI)–Cologne (CGN)
6. Nis (INI)–Tivat (TIV)
7. Nis (INI)–Athens (ATH)
8. Kraljevo (KVO)–Istanbul (IST)
9. Kraljevo (KVO)–Tivat (TIV)
10. Kraljevo (KVO)–Thessaloniki (SKG)



Amelia operates the following PSO routes:

1. Paris Orly (ORY)–Rodez (RDZ)
2. Paris Orly (ORY)–Brive (BVE)
3. Strasbourg (SXB)–Amsterdam (AMS)



Binter

Closed via competition:

Madeira:

1. Funchal (FNC)–Porto Santo (PXO)

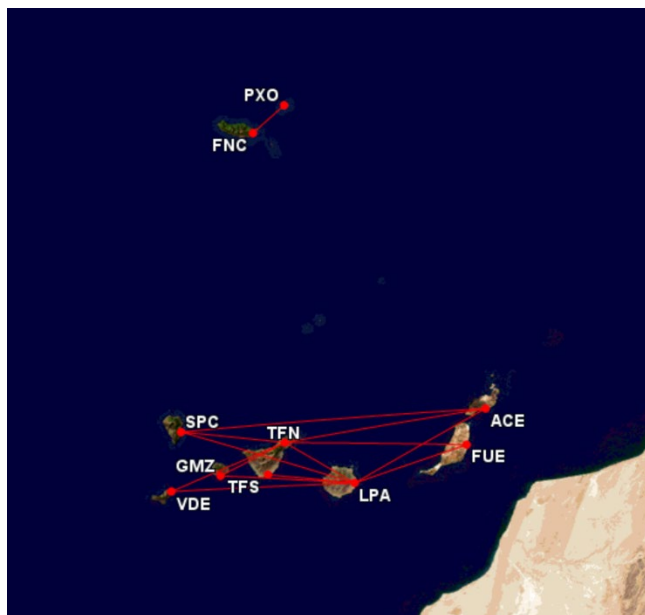
Closed via competition:

1. La Gomera (GMZ)–Gran Canaria (LPA)
2. La Gomera (GMZ)–Tenerife Norte (TFN)

Open:

Canarias:

1. Lanzarote (ACE)–Gran Canaria (LPA)
2. Lanzarote (ACE)–Tenerife Norte (TFN)
3. Lanzarote (ACE)–La Palma (SPC)
4. Fuerteventura (FUE)–Gran Canaria (LPA)
5. Fuerteventura (FUE)–Tenerife Norte (TFN)
6. Gran Canaria (LPA)–Tenerife Norte (TFN)
7. Gran Canaria (LPA)–Tenerife Sur (TFS)
8. Gran Canaria (LPA)–La Palma (SPC)
9. Gran Canaria (LPA)–El Hierro (VDE)
10. La Palma (SPC)–Tenerife Norte (TFN)
11. Tenerife Norte (TFN)–El Hierro (VDE)



CROATIA AIRLINES

Croatia Airlines operates the following routes and return PSO routes:

1. Zagreb (ZAG)–Dubrovnik (DBV)
2. Zagreb (ZAG)–Split (SPU)
3. Split (SPU)–Osijek (OSI)
4. Dubrovnik (DBV)–Osijek (OSI)–
5. Zagreb (ZAG)–Zadar (ZAD)–Pula (PUY)–Zagreb (ZAG)
6. Zagreb (ZAG)–Brač (BWK)





DAT operates PSO routes both in Italy (Sicily) and Norway.

Since 1 July 2018, DAT has operated five PSO routes in Sicily:

1. Lampedusa (LMP)–Palermo (PMO) and vv.
2. Lampedusa (LMP)–Catania (CTA) and vv.
3. Pantelleria (PNL)–Palermo (PMO) and vv.
4. Pantelleria (PNL)–Trapani (TPS) and vv.
5. Pantelleria (PNL)–Catania (CTA) and vv.

The other current PSO routes in Italy are:

- Sardinia: Cagliari to Rome Fiumicino and Milan Linate; Olbia to Rome Fiumicino and Milan Linate; Alghero to Rome Fiumicino and Milan Linate.
- Calabria: Crotone to Rome Fiumicino.
- Friuli Venezia Giulia: Trieste to Milan Linate.
- Marche: Ancona to Milan Linate, Rome Fiumicino and Naples.

DAT also operates the following PSO routes in Norway:

1. Røros–Oslo
2. Stord–Oslo
3. Florø–Oslo
4. Ørland–Oslo



From 2021, Eastern Airways (UK) has operated two PSO routes of considerably differing scale:

1. Connecting London as the UK capital with Newquay, Cornwall, with a 70-seat capacity aircraft and remains the only year-round multi-daily service at Newquay Airport.
2. An intra-Scotland service connecting Aberdeen with a remote airport in Wick John O'Groats, Caithness, Scotland on a 29-seat capacity aircraft and like many PSO routes, it is the only service at the small airport outpost.



From 2021, Emerald Airlines has operated one PSO route in Ireland:

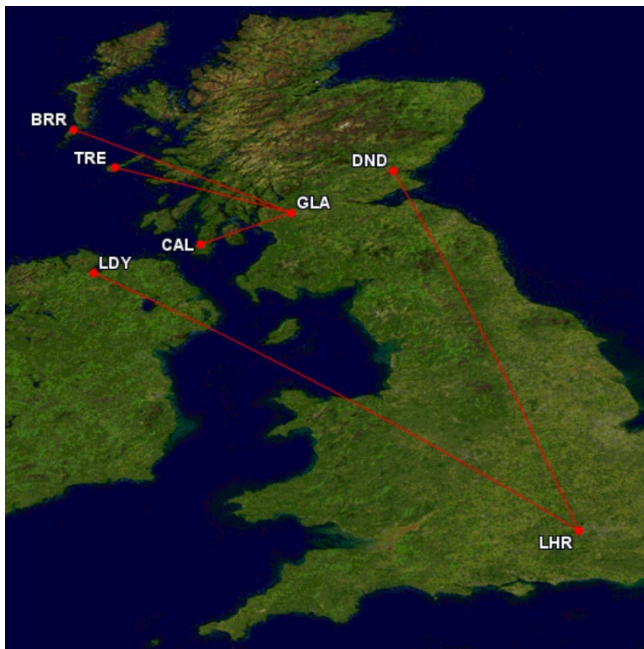
1. Dublin (DUB)–Donegal (CFN)





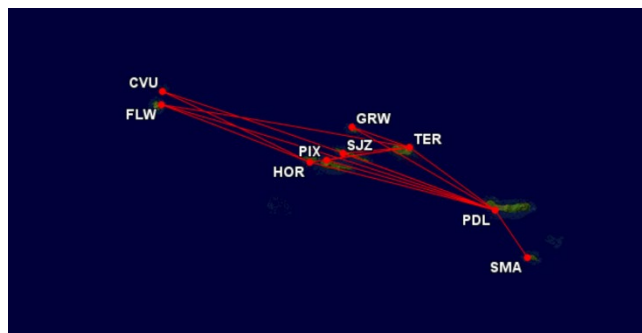
Loganair operates five main PSO routes (see below) and all of the PSO routes within the Orkney Inter Isles.

1. Glasgow (GLA)–Campbeltown (CAL)
2. Glasgow (GLA)–Tiree (TRE)
3. Glasgow (GLA)–Barra (BRR)
4. Dundee (DND)–London Heathrow (LHR)
5. Derry (LDY)–London Heathrow (LHR)



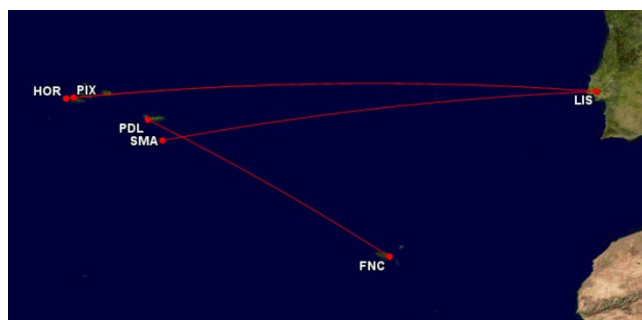
SATA Air Açores (SP) operates 15 PSO routes (see list below) between the islands of the Azores. All of them are closed PSO return routes:

1. Ponta Delgada (PDL)–Santa Maria (SMA)
2. Ponta Delgada (PDL)–Lajes (TER)
3. Ponta Delgada (PDL)–Graciosa Island (GRW)
4. Ponta Delgada (PDL)–São Jorge (SJZ)
5. Ponta Delgada (PDL)–Pico (PIX)
6. Ponta Delgada (PDL)–Horta (HOR)
7. Ponta Delgada (PDL)–Flores (FLW)
8. Ponta Delgada (PDL)–Corvo (CVU)
9. Lajes (TER)–Graciosa Island (GRW)
10. Lajes (TER)–São Jorge (SJZ)
11. Lajes (TER)–Pico (PIX)
12. Lajes (TER)–Horta (HOR)
13. Lajes (TER)–Flores (FLW)
14. Horta (HOR)–Flores (FLW)
15. Horta (HOR)–Corvo (CVU)



SATA Internacional – Azores Airlines (S4) operates a total of four PSO routes (see list below) between Portugal mainland and the Azores, as well as between the Azores and Madeira. These are all open PSO return routes:

1. Lisbon (LIS)–Horta (HOR)
2. Lisbon (LIS)–Pico (PIX)
3. Lisbon (LIS)–Santa Maria (SMA)
4. Ponta Delgada (PDL)–Madeira (FNC)





SKY express operates the following PSO routes:

1. Athens (ATH)–Astypalaia (JTY)
2. Athens (ATH)–Zakynthos (ZTH)
3. Athens (ATH)–Ikaria (JIK)
4. Athens (ATH)–Kalymnos (JKL)
5. Athens (ATH)–Karpathos (AOK)
6. Athens (ATH)–Kastoria (KSO)–Kozani (KZI)–Athens (ATH)
7. Athens (ATH)–Kythera (KIT)
8. Athens (ATH)–Milos (MLO)
9. Athens (ATH)–Naxos (JNX)
10. Athens (ATH)–Paros (PAS)
11. Athens (ATH)–Skiathos (JSI)
12. Athens (ATH)–Syros
13. Aktio (PVK)–Sitia (JSY)
14. Alexandroupolis (AXD)–Sitia (JSY)
15. Thessaloniki (SKG)–Corfu (CFU)
16. Thessaloniki (SKG)–Samos (SMI)
17. Thessaloniki (SKG)–Skyros (SKU)
18. Thessaloniki (SKG)–Chios (JKH)
19. Corfu (CFU)–Aktio (PVK)–Kefalonia (EFL)–Zakynthos (ZTH)
20. Limnos (LXS)–Mitilini (MJT)–Chios (JKH)–Samos (SMI)–Rhodes (RHO)
21. Rhodes (RHO)–Kos (KOS)–Kalymnos (JKL)–Leros (LRS)–Astypalaia (JTY)



Trade air has operated PSO routes within Croatia non-stop since 2014. Currently, flights are operated with Saab 340 aircraft (capacity 33 seats), connecting the Croatian mainland with its coast five days a week, on the following routes and return routes:

1. Rijeka (RJK)–Split (SPU)–Dubrovnik (DBV)–Split (SPU)–Rijeka (RJK)
2. Rijeka (RJK)–Zadar (ZAD)
3. Osijek (OSI)–Zagreb (ZAG)
4. Osijek (OSI)–Rijeka (RJK)
5. Osijek (OSI)–Zadar (ZAD)
6. Osijek–Pula (PUY)–Split (SPU)





Routes between Kirkenes, Vadsø, Vardø, Båtsfjord, Berlevåg, Mehamn, Honningsvåg, Hammerfest, Alta and Tromsø together with the following routes:

1. Hasvik (HAA)–Tromsø (TOS)
2. Hasvik (HAA)–Hammerfest (HFT)
3. Sørkjosen (SOJ)–Tromsø (TOS)
4. Lakselv (LKL)–Tromsø (TOS)
5. Andøya (ANX)–Bodø (BOO)
6. Andøya (ANX)–Tromsø (TOS)
7. Harstad (EVE)–Tromsø (TOS)
8. Narvik(NVK)–Tromsø (TOS)
9. Harstad (EVE)–Bodø (BOO)
10. Narvik(NVK)–Bodø (BOO)
11. Stokmarknes (SKN)–Bodø (BOO)
12. Stokmarknes (SKN)–Tromsø (TOS)
13. Svolvær (SVJ)–Bodø (BOO)
14. Leknes (LKN)–Bodø (BOO)
15. Røst (RET)–Bodø (BOO)
16. Brønnøysund (BNN)–Bodø (BOO)
17. Brønnøysund (BNN)–Trondheim (TRD)
18. Sandnessjøen (SSJ)–Bodø (BOO)
19. Sandnessjøen (SSJ)–Trondheim (TRD)
20. Mo i Rana (MQN)–Bodø (BOO)
21. Mo i Rana (MQN)–Trondheim (TRD)
22. Mosjøen (MJF)–Bodø (BOO)
23. Mosjøen (MJF)–Trondheim (TRD)
24. Namsos (OSY)–Trondheim (TRD)
25. Rørvik (RVK)–Trondheim (TRD)



Results

Types of PSO routes operated by ERA airlines

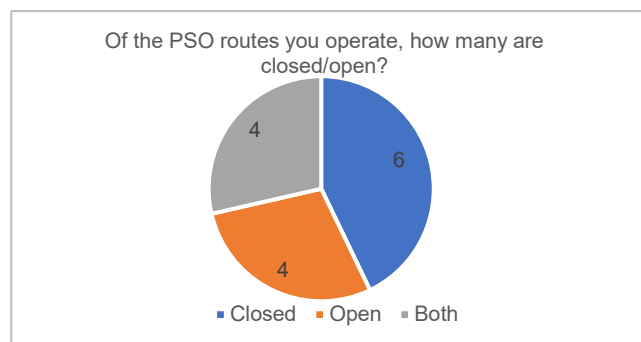
There are two types of PSO, open and closed (restricted).

Open access PSOs do not restrict the operation of air services to one carrier and no compensation is paid. Here the airline may be granted access to slots at a congested airport in order to operate the PSO.

Closed PSOs, on the other hand, restrict access to one carrier and compensation is paid in return for fulfilling the conditions of the contract.

The vast majority of PSO routes operated in Europe are closed. In this survey airlines were invited to declare how many open and closed PSOs they are operating. In Figure 2 below, there are four carriers that operate both types of PSOs. Six carriers operate closed PSOs while four declared that all their PSOs are open access.

Figure 2: Types of PSO routes operated by ERA airlines part of the study.³



³ Only PSO operators' responses are shown in this chart.

Compensation

Article 17 paragraph 8 of the Air Services Regulation states that MSs may grant compensation to the airline selected to operate the PSO route, provided that such compensation does not exceed the amount required to cover the net costs incurred in discharging each PSO, taking into account revenue generated by the air carrier and allowing for a reasonable profit.

Financial rebalancing of a PSO contract is allowed in some countries to compensate for the effects of unexpected, extreme or force majeure events, for example, an increase in fuel costs. However, this appears not to be the case in other MSs. ERA believes that there should be more consistency across the EU so that this mechanism is included in all PSO contracts.

Surveyed airlines were invited to provide information on PSO public authority compensation arrangements within their own jurisdictions. It is possible that there may be some variation in practice of compensation policy in those MSs where there are multiple public authorities managing PSOs.



Croatia – compensation is based on the difference between actual cost and revenue on a route at an annual level. The total amount of compensation per route is capped at annual level and this is based on what was offered at the time of the PSO tender.

France – compensation is calculated as the difference between the forecast revenue and expenditure.

In Corsica, the Office de Transports de Corse (OTC) determines the terms of reference and interested airlines submit their offer after having agreed on their profit and loss statement which establishes the forecasted loss, after deducting the company margin. It is a fixed maximum compensation per route per year.

In the case of the European PSO route (SXB–MAD), the tender does not set an economic limit and it is up to the company to present an offer

Greece – compensation corresponds to the net costs, plus a reasonable margin.

Ireland – the amount of compensation corresponds to the actual airline operational losses on an annual basis, or the value fixed in the contract, whichever is lower.

Italy – Sicilian PSO compensation is calculated as the difference between the forecast revenue and expenditure, plus the 'reasonable' margin of 4.7 per cent. In the most recent releases of Sicilian PSOs the maximum amount allocated by the Italian Government was insufficient as it did not take into account the fuel and general cost increases post COVID-19 pandemic, whereas fares were reduced by 34 per cent.

Portugal – for inter-island PSO routes in the Azores, the compensation corresponds to the airline operational losses on an annual basis or the compensation value fixed on the contract, whichever is lower. In the case of the Portugal Mainland/Madeira–Azores PSO routes, there is no compensation to the airline.

Norway – airlines bid for a fixed amount of support and the lowest bid (after a possible re-tender) wins. If two bids are relatively similar or if there is only one bidder, the national authority directly negotiates with the airlines. Compensation is calculated according to the following formula: calculated revenue - cost + profit.

Serbia – the maximum compensation is calculated and fixed per flight. Compensation covers operational loss and the amount is capped and cannot be exceeded.

Spain – generally calculated on the basis of the operating deficit, provided that this amount does not exceed a fixed ceiling and is capped by the authorities from the time the call for tenders is issued.

Sweden – compensation corresponds to a fixed annual sum, paid out monthly.

United Kingdom – the PSO has a set pricing structure which inhibits developing a route to be commercially viable in the longer term. In addition, airports constrain PSOs by charging all elements at tariff, making routes even less sustainable and less likely to become commercially viable. At the same time, airports complete commercial deals at

no, or heavily rebated, charging levels with other operators that essentially does not provide a level playing field for the PSO, and uses it as a cash cow rather than a stimulus to grow connectivity.

ERA policy recommendation(s)

- An economic market study should be carried out for each PSO to determine what compensation would be profitable for the airline.
- The PSO framework should provide for financial rebalancing mechanisms to compensate the airline in the event of a significant increase in costs and/or a significant reduction in revenue due to unforeseeable changes in the market (pandemic, war, increase in fuel, exchange rates, airport taxes, and so on).

Fares and discounts

Most PSO contracts across Europe include conditions limiting the amount airlines can charge passengers either through a cap in the air fare or setting specific fares and levels of discounts to categories of passengers (such as island residents).

It should be noted that there are airfare discount schemes in some jurisdictions that function outside their national PSO framework.

Croatia – PSOs do not include price caps or any special discount for residents. Fares are fully liberalised with levels determined commercially by the operator.

France – fares are not capped but even if it is up to the airline to determine the tariff, the airlines are limited by an average price. Revenue management on individual tickets is allowed, as long as the airline reaches the average annually. There are no specific fares or discounts for PSOs operated within mainland France, but some airlines have introduced business fares.

Corsica applies a two-tiered approach for PSOs where fares are fixed and capped for residents including permitting passengers full flexibility on changes and free luggage. For non-residents, fares are unregulated providing full pricing freedom for air carriers.

The Corsican PSO authority, the OTC, has defined a resident as a person who pays their taxes in Corsica, that is, those whose tax residence is in Corsica. There is a control system that issues an accreditation number to residents to be able to take advantage of the preferential rate when booking a ticket.

Greece – fares are capped for individual routes, since different price caps apply at different PSO routes.

Regarding the availability of additional discounts, the Greek ‘transportation equivalent cost’ mechanism directly grants an amount of money per ticket to permanent residents, but the subsidy does not apply to all Greek islands. Therefore, whenever a permanent resident from an eligible island travels, they apply a unique code which is submitted to the local authority (linked to the Ministry of Transportation) who in turn will provide an amount of compensation directly into the traveller’s bank account based on the distance travelled. This transportation equivalent cost mechanism is combined with the airfare cap.

Ireland – PSOs allow carriers to set a range of fares subject to various conditions being respected for the duration of the contract. The fare for a single flight must not exceed a pre-defined cap for 80 per cent of passengers. Carriers are free to set their own non-regulated fares to the balance of passengers nor are any discounts applied for residents or specific passenger groups.

Italy – there are predefined fares for residents (also applicable to workers on the islands) and for non-residents (40 per cent more expensive than resident fares), on top of airport charges. Both are capped. Other reduced fares (40 per cent rebate on resident fares) are available for offsite students commuting to/from the islands, athletes taking part in official sports events offsite, as well as accompanying technicians and travel companions for younger athletes (maximum 3,880 discounted tickets per year). On top of this, the airline must provide 20,000 free of charge seats (zero fare) per year to transport patients and pregnant women from Lampedusa or Pantelleria to mainland hospitals.



Norway – routes have a defined maximum fare. In addition, social discounts in the order of 50 per cent are offered to under 16s, over 67s and persons with disabilities.

Portugal – air fares are capped on PSO air services within the Azores archipelago. These include fare and applicable taxes, level of discounts for special fares, fare regulations/conditions including deadline for issuing tickets and penalties for changes or no shows. There is an air fare price cap for residents and non-residents on each route.

Portuguese PSOs also require additional air fare regulations for the following passenger categories:

- senior passengers (over 65 years old) without a cap or discount;
- youth passengers (between 12 and 26 years old) without a cap or discount;
- excursion fares without cap or discount;
- leisure fares without cap or discount;
- promotional fares without cap or discount;
- Child fares with a minimum discount of 45 per cent over the non-residents and residents capped values;
- infant fares with a minimum discount of 80 per cent over the non-residents and residents capped values;
- student fares with a minimum discount of 30 per cent over the residents capped values;
- family fares (more than 5 persons) with a minimum discount of 15 per cent over the residents capped values; or
- promotional fares for residents with a minimum discount of 20 per cent over the residents capped values.

For PSO routes between the Portuguese mainland and the Azores, as well as between the Azores and Madeira, air fares are liberalised except for a cap on resident and student fares. No compensation is paid to the airline for accepting these passengers.

An exception is made for some routes, for example, Funchal–Porto, Santo–Funchal, where a PSO route is operated exclusively by Binter Canarias.

Prices are fixed from origin to destination irrespective of the number of segments involved in the itinerary. Passengers are free to choose the itinerary and the combination of flights/segments, with no impact on the cost of the trip.

Serbia – there are no caps on air fares. The intention here is to enable the PSO routes to eventually transition to fully commercial unregulated operations.

Spain – fares are capped for PSOs operated within Spain. There are also discounts offered to residents of the Balearic Islands, Canary Islands and the North African territories of Ceuta and Melilla.

In the Canary Islands, the maximum prices are established for each route and it is up to the government to set the limits. Airlines can request a review of the price caps as a result of cost increases. Resident passengers have access to a discount of 75 per cent on all flights (inter-island and non-inter-island).

Furthermore, additional social air fares have been established by the airline for certain categories of

passengers with special conditions and prices: young people under the age of 22, university students under the age of 27 residing in the non-capital islands, people who have reached the age of 65, and federated teams in official competitions in the Autonomous Community of the Canary Islands.

Sweden – the average ticket price on PSOs must not exceed a set limit, which is calculated quarterly. There are also mandatory discounts for the elderly, students and young people.

United Kingdom – fares are capped with a minimum and maximum fare that are set for the entire duration of the PSO. This does not reflect market changes or cost inflationary pressures which distorts the benefit a PSO can bring and does not provide the flexibility required to adjust a PSO to fulfil its intended objectives.

Figure 3: Summarising the main features of PSO airfares for each country.

Country	No fares regulation	Fixed fares	Capped fares	Limited by average	Special fares for residents	Other social fares
Croatia	X					
France [mainland]				X		
France [Corsica]		X	X		X	
Greece			X		X	
Ireland			X			
Italy			X		X	X
Norway			X			X
Portugal			X		X	X
Serbia	X					
Spain			X		X	X
Sweden			X			X
United Kingdom			X			

Grouping of routes

Article 16 paragraph 10 of the Air Services Regulation states that PSO routes may be grouped together in a single invitation to tender for reasons of justified operational or administrative efficiency. In the former case (operational efficiency), grouping is permitted only in some exceptional cases (ultra-remote geography/low-traffic densities).

However, the application of this rule differs across Europe, with some countries tending to favour the grouping of PSO routes and others not.

France – for mainland PSOs, each route is handled on an individual basis. Airlines have the option of responding to the public tenders by offering to operate individual routes selected from the network. But most PSO tenders only include a single direct route between two airports.

In Corsica, the only exception concerns small routes below 100,000 passengers yearly from the same airport in the island.

Spain – contracts involve several routes and it is not possible to tender for the public offer by offering the operation for only one of the grouped routes.



Portugal – in the Azores archipelago, PSO routes are independent from one another. The interested airline can select individual routes from the multiple routes that are made available. Multiple carriers can operate one or more of these routes without compensation. However, in the next wave, it seems that this will no longer be possible because there is an overall compensation value that is not divided by route.

If no carrier is interested in operating these routes without compensation, then the Portuguese government will group them together (network) especially if there are related to a market with

similar characteristics. In this case, the government launches an international tender to guarantee the required level of service and the execution of the group of PSO routes by a single operator.

Italy – depending on the PSO, routes may or may not be grouped. In the case of the Sicilian PSOs, the five routes are grouped as a single package. Another example is the Sardinian or Ancona/Marche region where PSO routes are not grouped.

Croatia – each route can be tendered separately. Nothing prevents the bidder sending an offer for a group of routes, however each route will be assessed separately and awarded with the contract according to separate conditions.

Sweden – it is possible to place offers integrating several routes together if procurement conditions allow. Some routes are not allowed to include a stopover.

Greece – the Greek Civil Aviation Authority has grouped certain routes in the past, being reasonably cautious about not distorting competition and encouraging interested carriers to participate in the tender.

Ireland – grouping of routes is allowed and has been conducted in the past.

Norway – in Northern Norway, routes are largely grouped (up to a total of four to five aircraft) in order to achieve scale economics. In Southern Norway, the current tender announcements apply only to individual routes. The difference is partly due to the passenger base, but also geographical factors (including distance to various service facilities) and a political desire for dispersed settlement (including for export industries/national security reasons).

Air carriers always have to submit tenders on each single route, in case the outcome of the tender competition shows that a combination of single-route tenders rather than a grouped-route tender results in the lowest total compensation.

United Kingdom – on individual routes where no identical airport pair is operated, each route is independently applied and approved by the Secretary of State or the National Devolved Government. Most of these routes are individually tendered and awarded; one is a package of three

routes which also requires aircraft leasing by the government and will only fit the national operator (no real competition). The ability to bundle routes would provide better aircraft utilisation and significantly improved value for money from any subvention.

Serbia – the grouping of thin routes is allowed.

Figure 4: Current practices for grouping of routes per country.

Country	Yes	No
Croatia		X
France [mainland]		X
France [Corsica]	X ⁴	
Greece	X	
Ireland	X	
Italy	X ⁵	
Norway	X ⁶	
Portugal		X
Serbia	X	
Spain	X	
Sweden	X	
United Kingdom		X

ERA policy recommendation(s)

- Central and regional authorities should be granted a greater degree of flexibility and choice with regard to the grouping of PSO routes.

⁴ Only for routes below 100,000 passengers yearly from the same airport in the island.

⁵ Only for the PSO routes operated in Sicily.

⁶ Only for PSO routes operated in Northern Norway. In Southern Norway, the current tender announcements apply only to individual routes.

Contract terms and conditions

The conditions under which airlines must operate PSO routes are defined by each MS. Overall, there is a set of minimum requirements common to all airlines. These include:

- prices, including the maximum fare;
- minimum number of daily/weekly frequencies;
- minimum seating capacity and aircraft type;
- timetable requests, including the requirement for a return flight in one day;
- conditions regarding the use of aircraft with pressurised cabin and technical/operational capabilities;
- checked luggage requirements;
- cargo capacity; and
- access to a GDS booking system.

Croatia – minimum requirements are defined by season (summer, winter) and include the number of weekly frequencies, the minimum number of daily frequencies, the minimum capacity per departure and certain timetable requests. GDS distribution and options for connecting interline travel are obligatory.

France – minimum requirements for mainland France are defined in the specifications and vary according to public tenders. The following criteria are regularly applied: frequency, capacity and aircraft type, average price, time of departure and timetabling.

In Corsica the minimum requirements are defined by the OTC and amended and voted by the Assemblée de Corse (local elected assembly), while schedules are generally left to the airline. These include:

- fixed price and premium conditions for islanders;
- mandatory capacity per route per period;
- scheduling allowing day trips for islanders and for business visitors;
- minimum aircraft capacity;
- specific services such as stretchers, freight, dangerous goods, unaccompanied minors, specific travel advantages for students, distribution in all channels;
- high level of service such as regularity (including financial penalties); and
- mandatory technical and financial reporting.

Greece – most of the above-mentioned criteria are included in the PSO tenders in Greece. In relation to the aircraft size, no specific requirement is set as long as the aircraft is operationally suitable.

Ireland – the above common criteria applies. In addition, Irish PSO tenders stipulate a fixed timetable to be operated weekdays and weekends and a requirement for a substitute aircraft (in the event that the aircraft assigned to operate the service is not available for temporary periods) to ensure that the conditions of the PSO are respected and that there is no interruption to air service.

Italy – in addition to the standard minimum requirements already listed above, for the PSOs operated in Sicily there are freight requirements, such as the carriage of mail/newspapers/corpses in coffins, and the requirement for additional rotations whenever the load factor reaches 80 per cent 24 hours before departure (with no compensation for the operator for these additional rotations) whereas in cases where load factors drop below 50 per cent the carrier can 'formally' reduce the seats offered (frequency reduction is not allowed) using smaller capacity aircraft, although this has never materialised in the experience of Sicilian PSOs.



Norway – the minimum requirements in terms of frequency (per weekday and Saturday/Sunday) and timetable (first flight/last flight) may vary for each route or group of routes and are partly determined on the basis of information provided by the regions concerned.

There are also global requirements, such as the possibility of making a return trip to the capital on the same day and seating capacity per year.

On shorter routes, there are operational requirements, such as a pressurised cabin, navigation tools and minimum aircraft size.

Portugal – PSO conditions are published by the National Aviation Authority of Portugal and subject to a public tender.

In the Azores, the obligations arise from the conclusion and formalisation of the contract for the

concessionaire. Minimum requirements are defined in the contract; namely regarding the minimum number of frequencies, seating capacity, minimum weekly load/cargo capacity, aircraft capacity/configuration and others.

For example, regarding aircraft capacity, SATA Air Açores' equipment must have a minimum certified configuration of 35 seats, luggage capacity per passenger of 20kg and a load and/or mail capacity of 300 kg with a 75 per cent load factor. It is also necessary that the equipment must have the capacity to transport patients on a stretcher as well as two adult coffins duly packed in accordance with applicable regulations.

Moreover, there are also obligations regarding the timing of publishing flights (in terms of referrals for resident passengers and students), the terms of marketing flights and their respective prices for passengers as well as the terms of tariffs for the transport of cargo and mail.

Serbia – all these requirements are stipulated in the PSO tender. Determined routes with a weekly return frequency with requirements on the minimum aircraft seating capacity. In the evaluation of tenders, the public authorities assess bids using a price/quality of service ratio of 60/40.

Spain – the specifications of each contract indicate the conditions to be met on the route. These conditions are usually recurring: minimum offer of seats and service frequencies, fares, quality of service (regularity and punctuality), flight marketing channels, types of aircraft, age of the fleet and environmental requirements to reduce greenhouse gas emissions. These conditions are defined by an agreement of the Council of Ministers once the PSO is adopted.

Sweden – a number of minimum requirements apply, including the number of seats produced per year, the number of departures produced per year, fixed timetable, pressurised cabin, ability to carry 20kg of check-in baggage per passenger and online and GDS booking system.

United Kingdom – each of the minimum requirements varies, but most are low-volume remote services requiring smaller aircraft due to their PSO status, restricting the benefits, especially seasonally, that could be gleaned from capacity, frequency and timetable requirements are too rigid and do not allow the necessary seasonal flexibility. The one exception is a service operated to a beach airport dictated by tidal variation.

Figure 5: Overall minimum requirements per country.

Country	Airfares	Frequencies	Timetabling	Aircraft specificities*	Luggage	Cargo	Other**
Croatia		X	X	X			X
France [mainland]	X	X	X	X			
France [Corsica]	X	X	X	X		X	X
Greece	X	X	X				
Ireland	X	X	X	X			
Italy	X	X	X	X		X	
Norway	X	X	X	X			
Portugal	X	X		X	X	X	X
Serbia		X	X				
Spain	X	X		X			X
Sweden				X	X		X
United Kingdom				X			

* For example capacity, technical requirements etc.

** Including GDS distribution.

COVID-19 experience and ability to adapt PSO contracts

In general, once a PSO is in force, its implementation is rather rigid. The current PSO framework does not provide a clear mechanism to compensate airlines for operating losses incurred as a result of having to comply with continuation of services, even in the event of a significant reduction in demand and revenues, as was the case during the COVID-19 pandemic.

During the pandemic, the way in which each MS dealt with and defined exceptional measures to authorise a possible non-compliance with the PSO and/or the renewal of the PSO contract differed across Europe. In some MSs the procedure was quicker, with regulators demonstrating better understanding of the argument that unpredictable force majeure events require special measures, while in other countries it was difficult for some airlines to obtain permission to stop flying.

The financial cover was not always guaranteed, with the airline having to assume the financial risk in cases where losses exceeded estimates. For example, one MS extended existing PSO contracts by two years, up to the maximum permitted duration but did not change the financial conditions. The authorities were concerned that any change to the PSO conditions – including an increase of compensation – would breach public procurement procedures. There was no precedent to guide them.

The absence of an explicit and clear procedure at EU level left contracted airlines vulnerable to having to bear the losses incurred in having to maintain air services during this period.

The Air Services Regulation should provide the necessary regulatory tools to allow flexibility in the application of the PSO framework and a rapid reaction from the relevant Civil Aviation Authorities (CAAs), given that public procurement procedures can sometimes take longer than the market is able to accommodate.

Croatia – there is no procedure for PSOs to follow in times of crisis, and amending a PSO contract is usually a long process. During the COVID-19 pandemic, airlines were exempted from meeting the minimum requirements agreed in the PSO contract, as the authorities restricted travel.

France – During the COVID-19 pandemic, operations were halted and airlines operating

PSO routes reached an agreement with the authorities to reduce frequencies.

In Corsica, the compensation set out in the PSO contracts was paid in full, while flights never stopped. As a result, the contracts were not modified, but the management was different, with meetings and reports considerably strengthened, weekly exchanges between the parties and monthly reports (instead of once a year), in order to adapt capacity to demand and manage economics for continuity of services.



Greece – the Greek PSO routes were never suspended, due to lack of alternative connectivity. The continuation of the service was vital for the local communities, even under the restrictive measures against inbound traffic from abroad and the general lockdown.

Due to the COVID-19 pandemic, the Greek government announced in March 2020 the suspension of all public services concession tenders and the PSO tender process was not exempted from the scope of this extraordinary legislative decree.

The Hellenic Civil Aviation Authority has extended the existing PSO contracts by two years up to the maximum authorised limits but has not changed the conditions of the existing concession contracts. The PSO operators in Greece were left with no other option than to continue to operate as they had committed to the existing PSO concession contracts, even though the economic parameters of the operation of each PSO route had changed drastically.

The Greek public authorities were aware that they had to ensure that the conditions for public support to PSO operators remained in line with EU rules and that any initiative in favour of PSO operators could raise concerns about possible overcompensation (and thus compliance with EU state aid rules).

The civil aviation and transport authorities preferred to 'take the safe route', even if this meant delays due to public procurement procedures. Until the public procurement procedures were completed, the risk of under compensation was preferable to the risk of being found ex-post to have overcompensated a PSO operator without a thorough assessment of prices and costs. The PSO tender was finally announced in August 2022.

Ireland – the PSO contract can be amended by triggering certain clauses in the event of unforeseen changes in operating conditions affecting the PSO service. Triggering these clauses must be agreed between both parties.

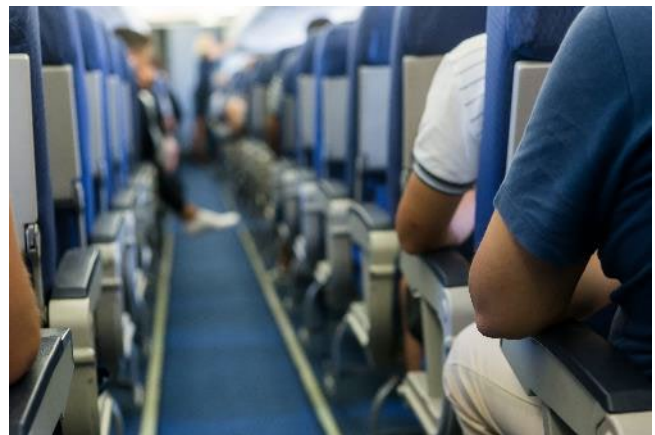
Italy – during the COVID-19 pandemic, compensation was given only to Italian operators. A non-Italian operator, DAT, was only authorised to reduce the frequency of flights during the peak of the COVID-19 pandemic, with the compensation being reduced proportionally according to the number of flights cancelled. A norm indicating that in case of pandemics, compensation should be paid in full despite the operator providing a reduced service, was released in that period and appears in more recent PSO agreements but despite numerous verbal reassurances from the Ministry of Infrastructure and Transportation it has not been applied retroactively to the Sicilian PSO ending 30 June 2022.

Norway – the PSO contract can be adapted in the event of substantial and unforeseen changes in the conditions underpinning it, as well as in case of any changes in government-imposed taxes and airport charges.

During the COVID-19 pandemic, the Norwegian government accepted a reduction in production and taxes as well as an increase in subsidies.

Portugal – the current contract for inter-island PSO routes within the Azores contains a clause relating to situations considered to be force majeure. It states that for all purposes of the contract, circumstances which make it impossible for either party to comply with the contract and which are beyond their control because the specific circumstances could not be foreseen at the date of performance of the contract and whose effects were not possible to avoid (such as the COVID-19 pandemic) constitutes force majeure. However, the PSO routes to/from mainland Portugal and from Madeira to the Azores were not subject to this special procedure.

The bureaucratic process with the national regulator to obtain special authorisation to temporarily stop the PSO service was overall a long and difficult dialogue. The Azores Government – as sole shareholder of SATA Azores Airlines – 'recommended' to SATA's Board of Directors the suspension of all flights operating into the Azores. This forced Azores Airlines to stop flying the PSO between the Azores and mainland Portugal, as well as between the Azores and Madeira and risking administrative sanctions and penalties. It was only after some persistence and wrangling with the Portuguese Civil Aviation Authority, that it was possible to obtain authorisation from the Government of the Portuguese Republic for the non-compliance, because of the exceptional period experienced.



Serbia – PSO operations were affected by the COVID-19 crises. For two months (April–May 2020) Air Serbia was completely grounded, after which they began a gradual recovery as demand returned. PSO routes recovered in the same way.

Spain – no specific procedure for adapting PSO contracts. Amendments to contracts follow the general procedure for amending public contracts, which is not flexible enough to respond promptly to the effects of a crisis. The COVID-19 pandemic was a good example of this gap. During the pandemic, the authorities tried to mitigate the consequences of the crisis by relaxing some conditions, for example, reduction of the number of flights.

Due to their strategic importance, PSO routes were the first to be restarted, since people had essential reasons to fly. There was a need to access vital services as healthcare, education and businesses.

Sweden – it is quite difficult to terminate a PSO agreement in Sweden, even when air transport is affected by a major worldwide event such as the COVID-19 pandemic.

The COVID-19 pandemic caused huge difficulties for airlines operating in Sweden because the Swedish Government took a very relaxed approach to the crisis by only ‘seriously recommending’ that people stay at home, without imposing a lockdown. It was therefore felt that the COVID-19 pandemic was perhaps not a situation in which the PSO requirements could be relaxed. All the negotiations aimed at easing PSO schedules required a great deal of persuasion (empty aircraft were not enough) and the discussions were lengthy.

In Estonia, on the TLL–KDL PSO agreement for example, the previous operator was allowed to withdraw from the agreement because of the increased costs and a new tender procedure was launched.

United Kingdom – the Isle of Man Government has funded routes to London, but not in open competition. It has used funds to support the stability of the routes in the short term. This has been through direct award rather than open PSO tendering.

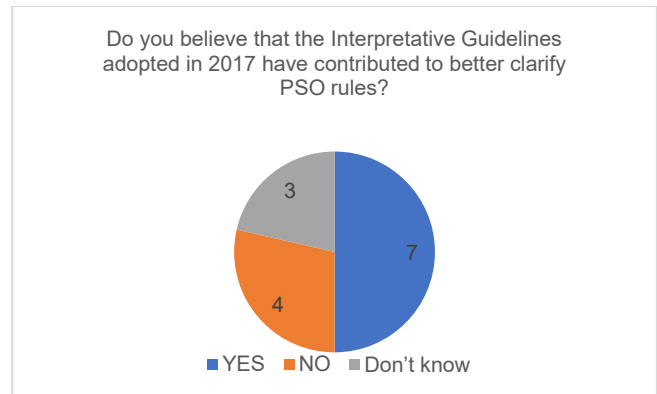
PSO awards immediately post COVID-19 were based on assumptions of traffic patterns reflecting pre-COVID, which is where the flexibility and adjustment is currently too restrictive in the UK.

ERA policy recommendation(s)

- Economic rebalancing should be recognised as a basic principle governing the PSO framework.
- In a time of crisis, force majeure or in the event of significant cost increases which were unforeseeable at the time the contract was concluded, the carrier should be able to renegotiate the PSO contract with the national or regional authority for the remaining period to ensure that the airline continues to cover its costs.
- ‘Emergency tenders’ should also be allowed on routes that are not already covered by the PSO framework. In these instances, social and economic necessity requires that essential connectivity be protected to remote communities dependent on air transport.

Interpretation of the rules and impact of the 2017 Interpretative Guidelines

Figure 6: Interpretative Guidelines and PSO rules.⁷



The 2017 Interpretative Guidelines are very comprehensive, providing sufficient scope to adapt the PSO framework to local conditions. However, national governments tend to interpret those guidelines in different ways. It is therefore important to adjust the Interpretative Guidelines and monitor what different authorities are implementing in their own countries.

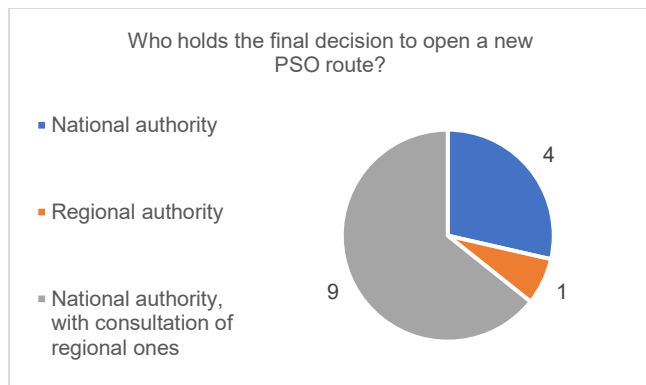
When it comes to the evaluation of rival bids in a PSO competitive tender, frameworks have been established locally and not on the basis of any level of EU-wide standardisation or harmonisation. Some MSs, for example, are much more vague on the scoring process than others. In addition, different countries assess PSO bids differently and require different levels of reporting from the air carrier.

There is also a lack of consistency in the administration of PSOs between MSs. Indeed, even an airline with PSO experience in one MS may not be able to use that experience when bidding for a contract in another, limiting the competitiveness of tendering processes, raising levels of compensation and reducing the efficiency of the single market for aviation.

⁷ Only PSO operators' responses are shown in this chart.

Role of national versus regional authorities

Figure 7: Decision to open a new PSO route.⁸



Under the current PSO framework, MSs determine which routes are eligible for a PSO tender and should therefore be subsidised. In most cases, national governments have the sole right to launch a PSO procedure. The gatekeeping role of national governments means that even when a regional or local authority is willing to subsidise a route in a PSO-type structure, it cannot initiate the process because only the national authorities can do this.

In Sweden, for instance, it is not possible for a municipality/region to initiate the process as the national government determines which routes qualify for PSO designation. This excludes many Swedish regions that aspire to have PSOs and invest in those routes because they see potential for attracting tourists or industries to the area.

Although regional authorities may have political influence via a consultative role, in most cases the final decision is still taken by the national authority. Often, the disparity between the political parties governing at local and national level makes it difficult to establish and operate PSO routes.

It is therefore essential to decentralise the decision-making process by giving a strong voice to local communities and regional authorities, as opposed to the current arrangement which confers exclusive PSO decision-making rights to national governments.

Croatia – the decision-making process is entirely at the national level. Consultations can be held with regional and county authorities to fully respect local needs.

France – in mainland France, there is a link between national and local authorities. In Corsica,

the entire PSO process is the responsibility of the regional authorities. In particular, the OTC plays a significant role.

Currently, PSO routes within mainland France, for example Orly–Rodez, Lyon–La Rochelle and so on, are managed by the national civil aviation authority (DGAC – Direction Générale de l'Aviation Civile) complemented by consultative arrangements with local authorities. Compensation is funded either wholly by the national government or partially in collaboration with the regions.

The situation in Corsica is different. Both the geography and specificities of the island made it possible via political pressure to introduce the concept of 'territorial continuity'. In the 1980s, a dedicated budget was allocated by the French state to PSO routes via a territorial continuity grant for air and sea transport and the management of those routes was entirely entrusted to the Collectivité de Corse.

Today, PSO routes are therefore an exclusively regional competence which falls to the Corsican Assembly. It has established an administrative body dedicated to this management – the OTC – which has the power to manage and control the organisation of PSO services (the vote remains with the Corsican Assembly). The budget is autonomously allocated by the Collectivité de Corse between air and sea transport, as well as infrastructure maintenance. The Collectivité de Corse is therefore legally and financially responsible for the smooth running of PSO routes.



Another interesting example of 'regionalisation' comes from the Bretagne region. The French (and Breton) airline project Celeste was born in 2021 with the ambition of developing a new airline to serve the regions, and first and foremost its home region, Morlaix, where the head office is located. Celeste obtained its AOC in March 2023 and is

⁸ Only PSO operators' responses are shown in this chart.

preparing to begin operations on the Brest–Orly route.

The special feature of this new airline project is the participation of public authorities in its capital with the *Chambre de commerce et d'industrie métropolitaine Bretagne Ouest* that invested €1.5m in Celeste. In June 2023, the region of Brittany had already granted Celeste a repayable advance of €1m as part of a €3.5m package, to which Morlaix Communauté contributed €2m and Brest Métropole €500,000.

Greece – the competence lies exclusively with the national authorities. Prior to the tender procedure, the central government consults the regional authorities to better understand their needs.

Ireland – all decisions are taken by the national government and local authorities are not involved in the PSO process.

Italy – in the Sicilian PSO case, as well as for the Marche, Calabria and Friuli regions' PSOs, the process is entirely managed by the *Ente Nazionale dell'Aviazione Civile (ENAC)*, the national CAA of Italy, acting as a liaison body between national and regional governments. In the case of Sardinia, the process is entirely managed by the region of Sardinia, with ENAC providing only general assistance.

Norway – the PSO process is entirely in the hands of the national authorities.

Portugal – for the inter-island PSO within the Azores archipelago, the decision-making process is in the hands of the regional government. For the Portugal mainland Madeira–Azores PSOs, responsibility lies with the national authorities, but the opinions and recommendations of regional/local bodies are generally considered.

Serbia – the decision making is in the hands of national authorities. However, regional and local authorities are consulted during the PSO process.

Spain – national authorities have the predominant weight in the decision-making process. Regional and local authorities can exert a certain amount of political pressure on the national government to establish or improve conditions for PSO routes in their respective territories. Some regions are also responsible for the economic part (in that they bear the cost of compensation).

Sweden – although the national authority states that it will base its decisions on input from local

authorities, experience shows the process is entirely in the hands of the national authority.

United Kingdom – the final decision on PSO is made by the UK national government, but there is support and influence from local authorities and the devolved administrations of Scotland, Wales and Northern Ireland. This is usually where the local authority or body owns and manages the regional airport in question, for example Dundee (Highlands and Islands Airports, owned by the Scottish Government), Newquay Airport (owned by Cornwall Council), Wick Airport (Highlands and Islands Airports). In some cases, a third party such as Dundee Council or Highlands and Islands Enterprise steer and manage the PSO beyond the tendering process, however usually require a partial contribution by the regional or devolved government to maintain the PSO.

ERA policy recommendation(s)

- Regional and local authorities promoting PSO routes should be able to receive approval from the EU institutions.
- Establish a common framework with homogeneous criteria at European level to resolve any conflicts of interpretation between national and local authorities.
- Ensure that PSO tenders can also be issued and processed in English.
- Establish an aid scheme to enable regions to provide support funding.

Implementation of environmental criteria and 'green PSOs' for thin routes

Regional carriers are committed to reducing the impact of their operations on the environment and contributing towards the fight against climate change. As commonly defined by the Destination 2050 report, aviation has several levers to achieve net-zero emissions by 2050 – namely new aircraft technologies, Sustainable Aviation Fuel (SAF), smart economic measures and operations optimisations. Today regional aviation can lever them all, also being a first mover when it comes to new aircraft technologies.

Yet, ERA believes that the priority for a PSO route is and should always remain ensuring the continued operation of routes serving islands or geographically dispersed, peripheral or underserved regions and thin routes, where air services are deemed essential to the region's economic and social development, but not commercially viable to be operated without public support. Hence, although we recognise the importance of decarbonisation objectives, we believe that, until the market of climate mitigation solutions is mature enough (for both SAF availability and affordability, and technology readiness), including environmental criteria as part of the evaluation of bids for PSOs would undermine this core objective.

PSOs are not designed as innovation instruments. They are intended to guarantee continuity, reliability and affordability of essential air services and therefore require a high degree of operational and financial certainty. Investment in climate mitigation solutions, by contrast, inherently involves technological and operational risk, which cannot be fully accommodated within the PSO framework without jeopardising its primary connectivity objective. The attractiveness of PSOs to airlines is already limited by the strictness of their conditions and/or the procedural complexity. At present, including environmental considerations in PSOs may put connectivity at risk by further discouraging participation in PSO tenders or even lead to the withdrawal of services, particularly where such considerations introduce additional operational, commercial or financial uncertainty for bidders. Overall, the main focus should be on improving the existing PSO framework, notably focusing on the financing of such routes, to facilitate the creation of new routes and increase connectivity.

However, if environmental considerations are to be included in the evaluation of bids for PSOs –

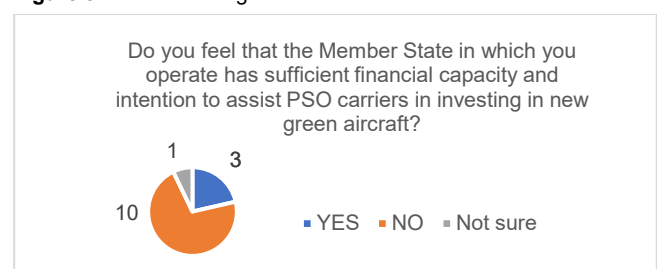
provided they are environmentally meaningful – , ERA airline members warn that they should never be exclusionary criteria and should come with strong safeguards in line with the reality of the market. For instance, extra points could be provided in the evaluation of the bids, based on the environmental performance of the aircraft used and its ability to minimise climate impact, assessed through the CO₂ emissions associated with operating the route but also ancillary metrics like non-CO₂ effects. For the potential allocation of an environmental bonus to be efficient and meaningful, it would have to be in line with local authorities' interest, which are best placed to understand their territories' needs and essential routes.

The reality of the aircraft market, supply chain issues, and regional carriers' limited financial capacity should also be considered by Member States when evaluating bids for PSOs. However, any final framework should never become a blanket measure for the adoption of strict environmental rules. Through the notification process, the Commission should ensure that environmental considerations are justified.

In the future, the development and deployment of low-carbon emission technologies will be key for short-distance flights and regional airlines. Yet, the financial reality faced by regional airlines should be acknowledged, as the industry cannot bear the burden of the upcoming EU regulations and at the same time invest in low carbon-emission technologies with its own financial means. This increased financial fragility endangers connectivity in the medium term, and risks delaying the full deployment of climate mitigation solutions. Additionally, investments made in new aircraft would be in vain if the regional airline ecosystem were to collapse because of mounting financial liabilities associated with the green transition.

Also, we note that currently, Member States have limited financial capacity and intention to support airlines in investing in this emerging market.

Figure 8: Investment in green aircraft.⁹



⁹ All ERA airlines part of the study responses are shown in this chart.

Croatia – currently, the selection criteria for PSO routes do not introduce green requirements and do not award special bonuses to environmentally friendly aircraft. However, due to the fact that compensation is limited but calculated as the difference between costs and revenue, it is in the interest of both the operator and the government to fly with aircraft that use less fuel.

France – financial capacity for greener aircraft is limited. Overall, PSO rules do not take account of the considerations, objectives and weight of the environmental transition in the decision-making process.

In **Corsica**, environmental elements are important in evaluation frameworks for PSOs, providing information to the public authority of the sustainability value of competing air carrier bids.

Greece – in the years following the financial crisis and the COVID-19 pandemic, the Greek state did not have the financial capacity to fund fleet renewal.

Ireland – PSO tenders require evidence of an environmental management plan to minimise adverse environmental impacts (CO₂ emissions, noise, and so on) and CO₂ emissions per passenger from the operation of PSO routes. Italy – currently no indication whatsoever has been given in any recent PSO concerning specific requirements for environmental considerations.

Norway – the Norwegian Government has the capacity and intention to support PSO carriers in the green transition. Currently, a clause in the PSO contract allows the parties to negotiate the conditions for the gradual introduction of zero-emission aircraft if this is possible during the tender period.

Portugal – at present, the selection criteria for PSO concessions do not take environmental considerations into account.

Spain – it is felt that Spain may have the financial capacity to encourage fleet renewal through the purchase of more sustainable aircraft, but the political intention is not yet clear. Indeed, recent political statements concerning the ban on short-haul flights do not give cause for optimism about the administration's intention to invest in more sustainable fleets. In any case, initial government support is essential to close the cost gap between traditional fuels and SAF.

Serbia – there is goodwill on the part of the State for modernisation and improvement with constant efforts for finding the possible investment solutions.

Sweden – PSO tenders do not award any points for newer/more environmentally friendly aircraft. Today, the only driven criteria seem to be the overall cost of the route, so the operator offering the cheapest deal will be awarded the route.

United Kingdom – currently, the Scottish Government do own two aircraft (De Havilland Twin Otters) which they then lease via another government entity (Highlands and Islands Airports) to the successful bidder of the PSO requiring a beach landing at Barra (Glasgow–Barra service). Otherwise on all other PSO services, no fuel specific or environmental specific requirements are prescribed.

Considering the elements above, ERA airline members would strongly welcome that the EU develops a separate scheme outside of the PSO framework for the deployment of low-carbon emission aircraft.

ERA policy recommendation(s)

- **Maintain PSO's core objective of connectivity:** Ensure that connectivity for peripheral and underserved regions is and remains the primary goal in the PSO framework. Until the market of climate mitigation solutions is mature enough (for both SAF and aircraft technology), policymakers and Member States should exclude environmental considerations from the PSO framework and the evaluation of bids. If environmental criteria are to be included, they should be non-exclusionary, function as extra points and consider the reality of local territories.
- **Create a separate scheme for the deployment of low-carbon emission aircraft:** Policymakers should refrain from creating a disproportionate financial pressure on airlines to invest in a particular aircraft technology. Instead, a scheme outside the PSO framework to support the investment in and deployment of low-emission aircraft should be considered.

Support from public authorities and private entities for non-PSO routes

PSOs are a critical tool to ensure essential connectivity but are not a strategic solution for long-term regional development. ERA airline members believe that the current legislative framework does not sufficiently allow them to commercially justify the operation of certain regional routes, nor to expand the network on new routes to guarantee regional connectivity in the long term.

Here it is worth remembering Nordica's experience with the routes GRQ–MUC and GRQ–CPH. Nordica wanted to use the PSO structure for the establishment of these routes, but it was hard to proceed because of a lack of experience and knowledge of the PSO model in the Netherlands. Without access to a PSO structure and to favour the establishment of regional connectivity, EU competition law requires that for an airport and/or region to establish a support scheme, the entities should act according to the Market Economy Investor Principle to comply with EU state aid rules. The aim of the Groningen project was to finance the start-up phase, but in the end, it unfortunately wasn't a 'success story'. The routes were abandoned for several reasons, including high competition with AMS without system integration, low load factors, price competition, loss of stakeholder confidence when goals are not met on time, and inability to meet all the criteria (capacity, connectivity, pricing, code-sharing, spare crew).

In airline economics, if one of the criteria above is not fulfilled, the route soon becomes vulnerable, especially if the airline is in direct competition with other carriers. The result is that today it is mostly holiday charter airlines who fly into small regional airports, not really serving the region and all its connectivity needs. With the risk of isolation, there is no growth for a region.

Airports, tourism authorities and/or other entities can support joint marketing activities which are always welcome to stimulate demand. However, this is not enough. At present, there is no explicit method for enabling private capital to contribute directly to the financing of thin commercial routes.

In parallel, the 2014 Aviation Guidelines can be deployed to support regional connectivity but require significant improvements. In particular, the conditions for start-up aid are too strict and the de minimis aid threshold of €275,000 should be increased at least up to €500,000 to match rising cost levels and inflation. This will help regional

airports and airlines to recover and maintain the same levels of regional connectivity within Europe's regions.

According to the Treaty on the Functioning of the European Union (TFEU) (art. 174), "The Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions". Among those, "particular attention shall be paid to (...) regions which suffer from severe and permanent natural or demographic handicaps such as (...) island".

However, today not all routes to and from insular EU regions and MSs qualify as PSO routes. EU legislation introduces a specific regime for outermost regions (art. 349 TFEU) but does not foresee the specificities of island MSs (such as Malta and Cyprus) or island regions (such as Sardinia). Therefore, ERA believes that other support measures for these specific routes need to be put in place to ensure minimum connectivity to the rest of the MSs and concrete access to the European Single Market.

ERA policy recommendation(s)

- Establish a dedicated and effective aid tool to enable public authorities to support airlines in assuming the financial risks of starting new routes, until the route becomes self-supporting.



Adapt EU261 liability

Up until now, the fares set in respect of PSO flights take no account of the amount of compensation payable pursuant to Regulation No. 261/2004 (EU261). The compensation payable pursuant to EU261 in relation to cancellation of a flight of less than 1,500km is €250, which significantly exceeds the maximum fare permitted to be charged in relation to the overwhelming majority of PSO flights operated within Europe.



Accordingly, EU261 operates in a discriminatory, unfair and anti-competitive fashion with regard to the operators of PSO flights. As a result of the application of EU261, the appetite of operators to bid for PSO contracts is reduced, which has the potential to reduce connectivity within the European regions to the significant detriment of the communities otherwise thereby served.

ERA policy recommendation(s)

- Limitation of the amount of compensation payable to passengers in relation to PSO flights to the amount of the fare paid by those passengers.

Disclaimer:

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policy.technical@eraa.org

European Regions Airline Association

Head office: Ground Floor, Suite 2, Continental House, Oak Ridge, West End, Woking, Surrey, GU24 9PJ, UK

Telephone: +44 (0)1276 856495 info@eraa.org www.eraa.org

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Brussels office: ERA c/o TOPOS, 25 rue d'Arlon, Brussels, B-1050, Belgium