



EU INTERREG III B Programme

The SEAPLANE Project

Sustainable and Efficient Air Transport - Platform for Linked Analysis
of the North Sea Air Transport Environment



European Community
European Regional
Development Fund



Interreg North Sea Region

Resolution to the Commission of the European Union, DG TREN, May 14th, 2004

Annex 6

Revision of the rules for Public Service Obligations [PSO] to ensure the continuity of regional air services to peripheral areas

Introduction

The current EU rules on Public Service Obligations (PSO) and their interpretation by individual EU Governments are proving inadequate to ensure the guaranteed continuity of regional air services to peripheral areas from network hub airports.

The SEAPLANE programme is seeking to revise the rules as defined in the “Third Package” under Council Regulation no. 2408/92, which enables member states to impose PSOs in respect of scheduled air services on low-density routes that are considered necessary for regional development.

The Need for PSOs

The relationship between the provision of high quality transport services and enhanced economic activity is well established.

In the case of air services, numerous studies have been undertaken by Governments, development agencies and airport associations which confirm the very positive contribution that airports and air service development can play in securing a region’s economic development and social cohesion.

Airports can only contribute to regional economic development and social cohesion if they can offer secure, frequent, regular and convenient air services, particularly to capital cities and network hub airports. For this, the airports are reliant on airlines.

However, capacity at many European major network hub airports is already under severe pressure with few commercially viable or attractive slots available. Over time, the shortage of slots means that even profitable regional routes are substituted by more profitable long and medium haul services at the constrained network hub airports.

Unless additional runway slot capacity is developed at such airports, either by constructing further runways (which is only a long-term option) or through improved operating procedures (See Annex 7), the only means of protecting the regional links is through the application of PSO designation.

The US Essential Air Services Programme

The USA has its own “Essential Air Services” (EAS) programme which was established in the 1978 Airline Deregulation Act. This permits access to federal subsidies for commuter airlines to provide service to small communities. The aim of the EAS programme is to guarantee continuing air service to those smaller communities that were served by major certificated air carriers before deregulation, so that they would still maintain a minimal level of scheduled air service.

The EAS programme is administered by the US Department of Transportation [DOT] and funded by the Federal Government.

The DOT currently subsidises commuter airlines to serve approximately 100 rural communities across the

USA that otherwise would not receive any scheduled air service. The DOT determines the minimum level of service required at each eligible community by specifying a hub through which the community is linked to the national network, a minimum number of round trips and available seats that must be provided to that hub, key characteristics of the aircraft to be used and the maximum permissible number of intermediate stops to the hub.

The EAS programme involves the designation of communities rather than specified routes as is the case with the EU.

Problems with EU PSO Regulation

There are a number of problems with the current process and its application:

1. The process remains too complex. It does not encourage applications to be made.
2. The validity of the concession is regarded as being too short at 3 years. It needs to be extended to at least 5 years.
3. The process is affected by the attitudes of individual member states. This leads to inconsistent application of the EU rules. It is suggested that a more consistent designation of PSO routes and service levels as well as EU funding for the programme would lead to a more efficient and more transparent programme, with better matching of funds to regional needs.
4. Entry protection and cabotage restrictions. Currently, entry onto a PSO route is restricted to one carrier for a period of up to 3 years. This contrasts with the US EAS program that allows another carrier to bid to offer replacement services for a lower level of subsidy. This keeps costs as low as possible and minimises subsidy payments. The rigidity of EU PSO procedures hampers expansion of services and prevents entry by another carrier for periods when demand may increase. The phased introduction of cabotage in the EU means that carriers registered in the state imposing the PSO have an advantage over non-national carriers – the “consecutive-cabotage” rule will hinder the growth of new cross-border routes.

Issues for the SEAPLANE initiative

1. Use of a PSO should be able to be designated to a specific network airport.
2. The issue of a PSO and the possible grant of operating subsidies should be separated. The issue is not about route profitability, the issue is to ensure access to network airports from the regions.
3. Any additional slots made available at network [hub] airports should be first offered to secure regional links through a PSO process.
4. The EU should be encouraged to ensure that its policies on regional aid, aviation and specifically on PSOs are fully coordinated.

A case study

The need for PSOs is best illustrated by a case study.

The Inverness – London link and UK policy

Background

The air route from Inverness to London is a key lifeline for the economic and social cohesion of the Highlands and Islands of Scotland.

Over the last 50 years the route has had a chequered history.

Originally operated by British European Airways and subsequently British Airways from Heathrow, the airline had always found it difficult to operate the route profitably.

In the early 1980s, BA transferred the route to Dan Air, who then operated the route successfully, achieving consistent £1 million annual profits.

However, in 1991, Dan Air was taken over by British Airways. Between 1991 and 1997 BA operated the route but with increasing losses, whilst pressure on scarce slots at Heathrow was also causing BA to re-assess its short haul network at Heathrow.

In 1996, BA rescheduled its three daily services to Heathrow and abandoned the early morning service to Heathrow and late evening return. To help fill this gap, KLM uk operated a once-daily nightstop aircraft between Inverness and Stansted. Meanwhile, later in 1996, easyJet started a new daily middle-day service between Inverness and Luton.

In November 1997 BA transferred the Inverness route, along with a number of other services to UK peripheral destinations, from Heathrow to Gatwick. In so doing the operation was transferred from BA mainline to an independent BA Franchise partner, British Regional Airways (BRAL). The vital night-stop service was re-introduced, but the aircraft type was changed from a 150 seat Boeing 737-400 to the slower 110 seat BAe 146-300. Thus the capacity available on the route was cut by some 30%. A key reason for the route transfer was that BA could make a far greater revenue and profit contribution per slot using the Inverness slots for intercontinental services rather than for UK domestic operations.

Despite the change of airport, BRAL operated the route to and from Gatwick successfully, it being considered one of their most important routes by its senior management.

Meanwhile, slot availability at both Heathrow and Gatwick as slot co-ordinated airports became ever more constrained, with a “shadow market” growing in slot transactions at both airports.

In 2001/2, after a further change of strategy, BA bought out a number of its regional Franchise partners including BRAL.

The result was that BA was once more operating the Inverness to London route but this time from Gatwick and now with a BAe 146, an aircraft with relatively high seat mile cost compared to the Boeing 737, particularly

within the high BA cost structure.

In February 2003, easyJet commenced a second middle of the day service from London to Inverness with a 737, this time from Gatwick, closely shadowing one of BA's three rotations. This in turn increased economic pressure on the existing BA full service network operation with the 3 daily BAe 146 operations.

The Heathrow carrier bmi commenced a single middle of the day operation from Inverness to Heathrow from the end of March; the essential link to Gatwick is now extremely vulnerable without new runway capacity in the London area or any form of slot protection. With the increasing value of Heathrow slots, there is no guarantee that the bmi operation will increase to more than the single daily middle of the day flights, or be sustained, but its launch will almost certainly reduce the profitability to the BA Gatwick operation.

This now gives Inverness three arrivals from London between 1100 and 1300, but with an overall service pattern that still leaves BA as the only carrier offering 3 services a day with the vital spread of schedules to maximise network connections.

UK regional routes to the network airports of Heathrow and Gatwick remain under growing threat as the pressure on scarce runway slots increases. Already Heathrow only serves 8 UK regional points whilst Gatwick serves 12. 8 UK cities have lost service to Heathrow or Gatwick entirely over the last 17 years. Belfast lost its BA service to Heathrow after 54 years. There is no guarantee that the residual bmi service or any other regional services will continue in the face of slot shortages.

There are 168 connecting destinations from Heathrow and 123 from Gatwick, but only 24 at Stansted and 11 at Luton. There are no long haul destinations served from either Luton or Stansted. Much Inverness traffic desire to connect to and from the USA.

A question remains as to how the UK regions are meant to develop economically and socially if they cannot be guaranteed access to the Heathrow and Gatwick networks? Single daily services by no-frills airlines cannot meet the needs of the business market and those connecting to and from international services at Heathrow or Gatwick.

None of the new services offer any guarantee of continuity, and none are subject to PSO protection. The concern is that the proliferation of marginally-costed "mid-day" services operated on an opportunistic basis will prejudice the vital network services across the day. With slots at Heathrow now trading at £5 million a slot, meaning £20 mn for a twice-daily morning and evening round trip: with increasing slot shortages at both Heathrow and Gatwick; and with no prospect of a new runway at Heathrow or Gatwick before 2020; there is an increasing danger that the network routes to Inverness will be lost in the next 5 to 10 years.

The price for slots at Heathrow has risen from £4 million to £5 million per slot in just six months. FlyBE recently sold slots to Virgin Atlantic and to QANTAS at £5 million per slot, while just six months ago BA bought Heathrow slots from United for £4 million each.

If this process continues then, over time, there will be further erosion of regional routes into Heathrow and eventually Gatwick. The opportunity cost of the slot will become too great for an airline not to either sell or move the domestic slots to more lucrative, long haul use. At current rates, the slot cost alone amounts to £2,700 per round trip for a ten year period – this would amount to £45 per round trip passenger on a route carrying an average of 60 passengers a flight.

With the first new runway in South East England planned to be at Stansted by 2011 at best, followed by Heathrow in around 2015 (assuming the emissions issues can be resolved), then this process will continue to accelerate over the next 10 years.

These issues were among a number of considerations covered in the UK Government's review of Aviation Policy.

The White Paper

The Government's Future of Air Transport White Paper was published on the 16th of December 2003.

Although its primary focus was to suggest new runways to serve London and the South East, it also covered broader regional airport and air service development issues. The policy called for the development of a new runway at Stansted by 2011, and a new runway at Heathrow by 2015 (subject to it meeting EU Emission standards which it fails to meet by a substantial margin) or a new runway at Gatwick post 2019. The Gatwick option would replace the Heathrow option if Heathrow failed the emissions test. Heathrow may be able to introduce mixed mode operations adding 20 – 50,000 slots post the availability of Terminal 5, but there is no guarantee and no commitment that such slots would be used for regional services.

Chapter 5 of the report (pages 63 to 71) refers to the potential for greater use of Public Service Obligation (PSO) protection and support for essential air services both within remote regions and also to protect links from the regions to London, which is also covered in Chapter 12.

Public Service Obligations

The White Paper makes a number of references to the issue and application of PSOs. Despite the apparent improvement in the position, the statements in the White Paper are effectively a re-iteration of the current policy. This includes the statement that in terms of adequacy of services London airports are defined as all London Airports – Heathrow, Gatwick, Stansted, Luton and London City.

The Government has called for notice periods of around four months if airlines are to vacate essential regional routes. There is no reference to how slots might be secured.

Additional work is to be commissioned by DfT on the potential to use PSOs, and there is likely to be a public consultation on the issue.

The airlines remain generally against the use of PSOs to and from London, as they wish to protect their London services. They do not want further constraints put on their flexibility to use scarce slots at Heathrow and Gatwick in the future.

The airports are also against any procedure which would reduce the average number of passengers per flight, and thus affect their earning power.

But key PSO issues remain unresolved by the White Paper:

1. Only Heathrow and Gatwick offer network-connecting opportunities (see attached chart). Both airports are effectively full today; both are under severe slot pressure. By 2010 there could be only a limited rump of full service network connections from the UK regions to Heathrow and Gatwick.
2. A new runway at Stansted in 2011 will do nothing to secure the vital connecting network links for Inverness and other peripheral locations, often overwater. It is understood that privately BAA admit that the first runway at Stansted is unlikely to be before 2014.
3. There is no guarantee of a new runway at Heathrow due to the serious problems with emissions. If it were to be built it would be more likely in a 2015 to 2020 timeframe.
4. There is no firm commitment to the application of PSO to protect regional links to specific airports in London.
5. The peripheral regions still do not have the commitment to early provision of dedicated runway capacity at Heathrow or Gatwick.

At the same time that the White Paper was published, the UK Government published its response to the Transport Select Committee report on Aviation.

The comments made on pages 14 and 15 seek to answer the Committee's concerns about the development of Regional Services and PSOs (paragraphs 40 - 46 and 59 of the Committee's report). To some extent they augment those in the White Paper on Regional services and access to London. But the policy line is still that the Government will not seek to change the basis or interpretation of the EU PSO guidelines.

The relevant text from the Government response says:

“The Government notes and shares the Committee’s concern about access to London airports for air services from the regions. It recognises that changes in slot allocation rules to encourage trading will not mean that all the economic (and other) benefits that domestic air services to London (Heathrow, Gatwick, Stansted, Luton and London City) may bring to other parts of the UK will be fully reflected. As stated in Chapter 4 of the White Paper, the Government recognises the importance of these services and is prepared to intervene in the market, in well defined circumstances, to protect slots at the London airports for regional services by imposing Public Service Obligations (PSOs) in certain limited circumstances.

The Government will apply PSOs where, in accordance with the existing EU Regulation 2408/92, three criteria are met:

(1) The route is to a peripheral region, or to a development region, or is a ‘thin’ route (the Government will be consulting shortly on the details of this);

(2) The air service concerned is vital to economic development for the region; and

(3) PSO is required to ensure an adequate level of service. (We will be consulting regional stakeholders and the aviation industry on an appropriate definition of ‘adequate’, bearing in mind the importance to travellers of services at both peak and off-peak times.)

The Government will work closely with the European Commission and other Member States with the aim of ensuring that any amendments to the relevant regulations will recognise the importance of regional access to London airports. In the interim, clear guidelines will be developed so that any applications for the imposition of PSOs on routes from regional airports into London can be processed in an objective and transparent manner.

Under current Community law it is not possible to impose a PSO on a route between two cities or regions on which adequate services are already being operated commercially and the airline concerned has no intention of withdrawing from the route. We propose that, where there is an existing service, PSOs would be imposed only when an airline’s withdrawal from a currently operated route would reduce the frequency level below an adequate level. In judging whether there was an adequate service, we would take into account the frequency of services, the timing of the services, and the seat capacity offered. Airlines currently operating services to London airports will be asked to provide the Government with at least four months’ notice of their intention to withdraw from a route or reduce frequencies if, as a consequence of such withdrawal or reduction in service, the overall level of service went below an adequate level.

Demonstrating the importance of the service to the economic development of the region concerned will be the responsibility of local bodies such as the relevant Devolved Administration, Regional Development Agency or local authority. It will also be for these bodies to reimburse the Department for Transport any funds provided for subsidies, should these be required”.