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Price: EUR 4

(¹) Text with EEA relevance

EN

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IV

(Acts adopted before 1 December 2009 under the EC Treaty, the EU Treaty and the Euratom Treaty)

COMMISSION DECISION

of 14 September 2005

State aid measure C 11/04 (ex NN 4/03) — Olympic Airways — Restructuring and privatisation

(notified under document C(2005) 2706)

(Only the Greek text is authentic)

(Text with EEA relevance)

(2011/97/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above ⁽¹⁾,

Whereas:

on 9 September 2003. By letter dated 17 September 2003 (TREN A/30881), the Greek authorities stated that they intended to submit this information in due course.

(4) On 25 September 2003 the Commission received an official complaint about the privatisation of Olympic Airways from a competitor, Aegean Airlines (TREN A/30589).

(5) The Privatisation Law and the reply to the information injunction were sent to the Commission by letter dated 29 September 2003 (TREN A/30866). Certain information was still missing, however, and the Commission advised the Greek authorities accordingly, by letter dated 31 October 2003 (TREN D/17821), a copy of which was also subsequently faxed to the Greek Permanent Representation on 4 December 2003.

1. PROCEDURE

(1) In a letter dated 3 March 2003 (TREN A/26534, 25 July 2003) the Greek authorities underlined their commitment to privatise the State-owned airline Olympic Airways and described the steps they had already taken to that end.

(2) In the absence of a formal notification, the Commission issued an information injunction on 8 September 2003, which was notified to the Greek authorities on 9 September 2003 (C(2003) 3266). This required the Greek authorities to provide all the information necessary to enable the Commission to examine whether the measures for the restructuring and privatisation of Olympic Airways were compatible with Article 87 of the Treaty.

(3) On the same day the Commission wrote to the Greek authorities (TREN D/15287) insisting that they should notify the Commission of the law providing for the privatisation of Olympic Airways, which was adopted

(6) On 12 December 2003, before the Commission had completed its examination of the compatibility with Article 87 of the Treaty of the measures for the restructuring and privatisation of Olympic Airways, a new company came into being, under the name 'Olympic Airlines'. The information injunction proceedings initiated by the Commission on 8 September 2003 were therefore now entered in the State aid register under case number NN 4/03.

(7) On 15 December 2003 (TREN D/22742), the Commission reiterated its request for information on the privatisation; the Greek authorities provided the information requested by letters dated 18 and 19 December 2003 (TREN A/38288 and TREN A/38258).

(8) On 15 January 2004, a new request for additional information was sent to the Greek authorities (TREN D/160), who replied in two letters both dated 16 January 2004 (TREN A/11076 and TREN A/11077).

⁽¹⁾ OJ C 192, 2.7.2004, p. 2.

- (9) On 16 January 2004 the Commission wrote to the Greek authorities regarding Athens International Airport ('AIA'), at Spata, and its ongoing relationship with Olympic Airways/Airlines. The Greek authorities replied by letter dated 23 February 2004. A further request for information on this subject was sent to the Greek authorities on 15 June 2004, and answers to that letter were received on 4 August 2004.
- (10) By decision of 16 March 2004, notified to Greece by letter dated 16 March 2004 (SG(2002) D/228848), the Commission initiated the procedure laid down in Article 88(2) of the Treaty. The case was registered under number C 11/04.
- (11) The Commission's decision to initiate the formal investigation procedure was also published in the *Official Journal of the European Union* ⁽²⁾. The Commission there invited interested parties to submit their comments. Greece sent comments to the Commission by letter dated 11 June 2004.
- (12) Within the time allowed by the notice announcing the initiation of the procedure the Commission received comments from two other interested parties. These comments were submitted to the Greek authorities for their observations. Greece's observations were received on 3 November 2004.
- (13) On 11 October 2004 the Commission sent a letter giving the Greek authorities formal notice that it intended to issue a suspension injunction if within ten days of receipt of the letter it did not receive satisfactory information demonstrating that Greece was no longer making aid payments to the beneficiaries. The Greek authorities were asked to submit their comments on the matter. The Greek authorities replied to this letter of formal notice on 28 October 2004. Greece argued that issuing an injunction at this stage would seriously jeopardise the intensive efforts Greece was making to find a solution, and would be disproportionate and unjustified.
- (14) Since the submission of those observations the representatives of the Greek authorities have at regular intervals kept the Commission services apprised of developments with regard to this point (at meetings dated 17 December 2004, 19 December 2004, 3 February 2005, 7 February 2005 and 28 April 2005, and by letters dated 22 February 2005 and 19 April 2005) and with regard to the ongoing restructuring and privatisation of Olympic Airlines and of Olympic Airways Services.
- (15) They have also provided the Commission departments with information on the following issues:
- Law 3259/2004, granting Olympic Airways temporary immunity against enforcement proceedings brought by creditors (e-mail dated 22 December 2004), and
 - Law 3282/2004, whereby the State took over Olympic Airways' obligations towards financial institutions in respect of the financing and leasing arrangements for Olympic Airlines' Airbus A340-300 aircraft. (e-mails dated 22 December 2004 and 4 April 2005).
- These additional clarifications will be taken into consideration in the present Decision where they are relevant to the subject matter and shed light on the questions the Commission raised when it initiated the procedure.

2. THE FACTS

2.1. PAST COMMISSION DECISIONS REGARDING OLYMPIC AIRWAYS AND ITS SUBSIDIARIES

The 1994 Decision

- (16) On 7 October 1994 the Commission adopted Decision 94/696/EC ⁽³⁾ ('the 1994 Decision') declaring that aid granted or to be granted by the Greek State to Olympic Airways was compatible with the common market provided that Greece met a series of commitments listed in the Decision.

The 1998 Decision

- (17) Several of the conditions attached to the 1994 Decision were not observed, and on 30 April 1996 the Commission decided to reopen the procedure laid down in Article 88(2) of the Treaty and to initiate proceedings with regard to new and non-notified aid which had come to its attention ⁽⁴⁾.
- (18) On 14 August 1998, the Commission adopted Decision 1999/332/EC ⁽⁵⁾ ('the 1998 Decision') declaring that certain aid granted or to be granted by Greece to Olympic Airways was compatible with the common market in the context of a restructuring plan covering the period 1998-2002. Once again the aid was authorised subject to a number of conditions.

⁽³⁾ OJ L 273, 25.10.1994, p. 22.

⁽⁴⁾ OJ C 176, 19.6.1996, p. 5.

⁽⁵⁾ OJ L 128, 21.5.1999, p. 1.

⁽²⁾ See footnote 1.

The 2000 Decision

- (19) In July 2000 Greece notified the Commission that it intended to use the remaining authorised aid for a series of loan guarantees, to be contracted before the end of 2000, for the purchase of new aircraft and for investment necessary for the relocation of Olympic Airways to Athens International Airport at Spata. By letter of 10 November 2000 (SG(2000) D/108307), the Commission informed the Greek authorities that it had decided to amend part of the 1998 Decision with regard to the aid measure concerning the loan guarantees.

The 2002 Decision

- (20) On 6 March 2002 the Commission decided to initiate the formal investigation procedure laid down in Article 88(2) of the Treaty. It expressed concern that the aid allowed by the 1994 and 1998 Decisions might have been misused, that the company's restructuring plan might not have been implemented, and that new illegal State aid might have been granted.
- (21) On 9 August 2002 the Commission sent the Greek authorities a further injunction requiring them to provide the information previously requested. In particular, it sought accounts and figures relating to the payment of operating costs by the State. The replies provided by Greece were insufficient.
- (22) On 11 December 2002 the Commission adopted a final negative decision concerning aid granted by Greece to Olympic Airways (Decision 2003/372/EC⁽⁶⁾, 'the 2002 Decision'). The Commission there found that aid previously granted by the State and authorised by the Commission was incompatible with the Treaty on account of the failure to comply with the relevant conditions, notably the failure correctly to implement the restructuring plan. In addition, the Commission found that Olympic Airways had received new aid that was illegal and incompatible with the common market, in that the Greek State had tolerated the non-payment or deferment of the payment dates of certain social security payments, value added tax on fuel and spare parts, rents payable to airports, airport charges, and a tax imposed on passengers departing from Greek airports known as *spatosimo*.
- (23) The Decision required Greece to take the necessary measures to recover from the beneficiary the aid of GRD 14 billion (EUR 41 million) referred to in Article 1 of the Decision, and the new aid referred in Article 2; recovery was to be effected without delay and in accordance with the procedures of national law

provided they allowed the immediate and effective execution of the Decision. The aid to be recovered was to include interest from the date on which it was at the disposal of the beneficiary until the date of its recovery.

- (24) Greece was to inform the Commission within a period of two months from the date of notification of the Decision of the measures it was taking to comply with it. The Decision was notified to the Greek authorities by letter dated 13 December 2002 (SG(02) D/233148), and was published in the *Official Journal of the European Union* on 28 May 2003.

- (25) On 11 February 2003, following on from the 2002 Decision, the Greek Government informed the Commission that it had received independent advice that Olympic Airways had not received preferential treatment, and that therefore the Government would not implement the requirements of the Decision regarding the recovery of the sums that the Commission had judged incompatible.

Follow-up to the 2002 Decision

- (26) On 24 February 2003 Olympic Airways brought an action challenging the Decision before the Court of First Instance (Case T-68/03). Greece did not ask to join the action, and did not bring a separate action challenging the Decision before the Court.
- (27) On 6 March 2003 the Commission informed the Greek Government that it was under an obligation to comply with the 2002 Decision. On 26 June 2003 the Greek Government replied, saying that it was examining the legal effects of the 2002 Decision and of the procedure the Commission had followed in adopting it. It also assured the Commission that it intended to carry out the recovery. It did not carry out the recovery, nor did it provide the Commission with a timetable for doing so. The Commission was accordingly obliged to bring an action before the Court of Justice for failure to comply with the Decision, which it did on 3 October 2003 (Case C-415/03).
- (28) The Court of Justice ruled in the case on 12 May 2005: it found in favour of the Commission⁽⁷⁾. The Court (Second Chamber) declared that by failing to take within the prescribed period all the measures necessary for repayment of the aid found to be unlawful and incompatible with the common market — except that relating to the contributions to the national social security institution — Greece had failed to fulfil its obligations.

⁽⁶⁾ OJ L 132, 28.5.2003, p. 1.

⁽⁷⁾ Not yet reported in the ECR.

- (29) On 23 May 2005 the Commission wrote to the Greek authorities regarding the measures to be taken by Greece to ensure compliance with the judgment of the Court of Justice.
- (30) The Greek authorities replied by letter dated 2 June 2005, reiterating their willingness to cooperate fully with the Commission in the matter. That reply will be summarised below in so far as it relates to the matters raised when the procedure was initiated.
- (31) The aid found to be incompatible in the 2002 Decision has not yet been recovered. The Commission may bring an action under Article 228 of the EC Treaty for failure to comply with the judgment.
- (32) The present Decision, however, concerns only the decisions or measures taken by the Greek authorities for the benefit of Olympic Airways and its successors after the 2002 Decision was adopted.

3. THE INITIATION OF THE PROCEDURE

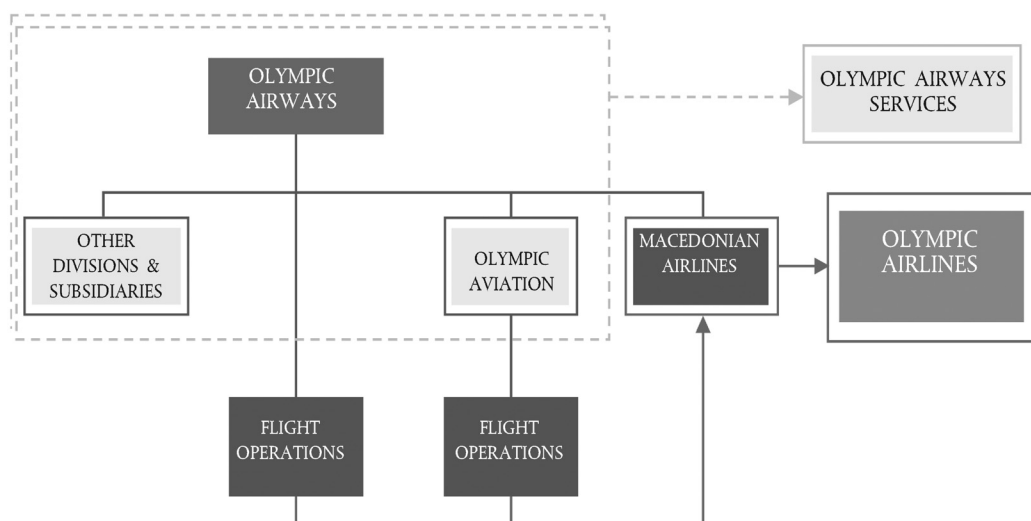
The Commission decided to initiate the procedure laid down in Article 88(2) on a number of grounds:

3.1. THE COMPANY'S CONTINUED FAILURE TO PAY TAX AND SOCIAL SECURITY CONTRIBUTIONS

- (33) Olympic Airways has been loss-making since 2002. Its profitability continues to be negative. Its core business, rather than generating income, is reducing the overall value of the company year on year. It is difficult if not impossible to believe, therefore, that it has been able to continue in business only because it has not been paying its debts to the State. In the 2002 Decision this failure to collect debts was found to constitute illegal State aid.
- (34) The Commission took the view, therefore, that the State was de facto if not de jure Olympic Airways' principal creditor, and that if it were not for continued State intervention the company would long since have ceased operations.

3.2. THE STRUCTURAL REORGANISATION OF THE COMPANY

- (35) When it initiated the procedure the Commission was aware of the existence of Law 3185/2003, which provided that the flight divisions of the various companies within the old Olympic Airways group, namely Olympic Aviation and Macedonian Airlines ('Macedonian'), were to be hived off and regrouped into a single entity, the former Macedonian, now renamed 'Olympic Airlines'. The non-flight divisions were to stay within Olympic Airways, now renamed 'Olympic Air Services'. Law 3185/2003 provided that an identical procedure could be undertaken in respect of the ground handling and maintenance and engineering divisions, although to date this has not been done.



- (36) When it initiated the procedure the Commission took the view that Greece, having failed to privatise the Olympic Airways group as a whole, had decided to divide it into separate units that would be more attractive to potential investors, and to dissociate the units from Olympic Airways' liabilities.

- (37) And indeed what appears to have happened after the restructuring of the Olympic Airways group is that since December 2003 all flight activities have been concentrated in the new Olympic Airlines, and all other activities, principally ground handling and maintenance and engineering, remain with the old company, now called Olympic Air Services. Olympic Air Services also retains a number of majority shareholdings in other aviation-related companies in Greece providing such things as catering, information technology and fuel services.
- (38) The Privatisation Law specifies that the transfer of assets and liabilities and any other entitlements to the new company is exempt from any tax, levy or fee payable to the State, to any legal person governed by public law or to any other public body. Such transfers are also exempt from any charge, debt or claim on the part of third parties, whether natural or legal persons, with the exception of the obligations that are expressly mentioned in the conversion balance sheet. Additionally, Article 27 of Law 3185/2003 stipulates that in respect of debts that Olympic Airways contracted before the hive-off of the flight division the new company is exempted from the application of Articles 479 and 939 of the Civil Code⁽⁸⁾ and Articles 537 and following of the Commercial Code. Following this measure, therefore, creditors will be able to bring claims only in respect of debts that are transferred to Olympic Airlines, and will not be able to bring claims against the new company in respect of debts remaining with Olympic Airways. Subsequently, on 15 October 2004, the Greek authorities enacted Law 3259/2004, which gave Olympic Airways temporary immunity against enforcement proceedings brought by creditors.
- (39) In application of Law 3185/2003, the Greek State engaged consultants Deloitte & Touche to determine the value of the flight divisions of the Olympic Airways group. The consultants were also asked to prepare a restructuring plan and to draw up a report on the state of Olympic Airways and Olympic Aviation with a view to determining the number and type of employees to be transferred to Olympic Airlines. Deloitte & Touche indicated that they had not carried out an audit and that they were working solely on the basis of information provided by Olympic Airways and Olympic Aviation management. Additionally, Deloitte & Touche did not include in their evaluation the aircraft owned by Olympic Airways and Olympic Aviation; the value of the aircraft was calculated by another external consultant, Airclaims Ltd, at a market price of EUR 120 million.
- (40) Public service obligations were transferred from Olympic Aviation to Olympic Airlines without a public tender. It appears that Olympic Aviation had secured the sum of EUR 10 million in debt to AIA airport on the earnings from these public service obligations, and that that loan remained with Olympic Aviation, notwithstanding the fact that the public service obligations were now to be performed by Olympic Airlines.
- (41) Presidential Decree 178/2002, which transposes Council Directive 98/50/EC⁽⁹⁾ into Greek law, stipulates that in the case of a transfer of an activity from one undertaking to another, by whatever method, employees connected with that activity are to be transferred to the new undertaking on the same terms and with the same rights as before. It was the intention of the Greek authorities, however, to change the status of the employees. For this to happen, Presidential Decree 178/2002 required that negotiations take place.
- (42) At the time of the hive-off there were almost 300 specific laws, collective agreements or other provisions applying to Olympic Airways staff as a whole. The Greek authorities therefore considered it important to modify the legislative framework and to renegotiate the collective agreements, especially as the group employed 6 171 persons in June 2003 (approximately 1 850 staff moved to Olympic Airlines), and personnel costs represented 38 % of total revenue, when the average for the industry was around 22–26 %. Consequently, Article 27 of Law 3185/2003 envisaged a number of changes. Law 2190/1994, which concerns the administrative recruitment procedure for companies in the public sector, would not apply to Olympic Airlines. Employees who were entitled to retire in 2003 or 2004 under the applicable collective agreements would have their rights respected.
- (43) In contrast to Olympic Airways, which had financed its operations exclusively from debt, it was intended that Olympic Airlines would use its own funds. Olympic Airlines began operations with little or no debt, and this was due in no small part to the choice of the items transferred to the new entity. As regards liabilities, when it began operations the new company inherited no financial debt from the parent company, which was indebted at that stage to the tune of EUR 207 million.

⁽⁸⁾ Both articles refer to the rights of creditors to protection in the context of transfers of assets.

⁽⁹⁾ OJ L 201, 17.7.1998, p. 88.

- (44) Under the relevant provisions of Greek bankruptcy law (Law 2190/1920), when a division, sector or department is hived off and absorbed by an operational company, the shares in the operational company remain with the original company. What this means in this case is that the shares in Olympic Airlines ought to have remained in the ownership of Olympic Airways. However, Article 27 of Law 3185/2003 stipulates that within the framework of the privatisation procedure all the shares deriving from the hive-off of the various divisions of Olympic Airways are to devolve to the Greek State. Moreover, any monies resulting from the subsequent sale of these divisions will be used to discharge Olympic Airways' debts and obligations. Greece has indicated that by this procedure the financial assets are transferred to the State at a value that cannot be called into question, in so far as it is the product of an evaluation carried out by auditors. Moreover, the Greek State considers that when they are sold by the State these assets will generate a price higher than they would have done if the shareholding had not been transferred to it.

3.3. THE 'ADVANCE' OF EUR 130 312 450 TO OLYMPIC AIRWAYS

- (45) By Ministerial Decree 2/71992/A0024 of 22 December 2003, enacted pursuant to Article 27 of Law 3185/2003, the Greek State opened a special account at the Bank of Greece entitled 'Greek State — Denationalisation account of the Olympic Airways group'. The account is to be credited with the proceeds of any sale, within the framework of the privatisation procedure, of companies within the Olympic Airways group whose shares have been transferred to the Greek State (the first being Olympic Airlines). Nevertheless, to cover expenditure necessary pending the privatisation of the companies within the group, the account was credited by the State with a sum described as an 'advance' (*prokatavoli*) or 'prepayment' (*propliromi*). This advance is equal to the nominal share capital of Olympic Airlines (EUR 130 312 450).
- (46) Those parts of Olympic Airways' liabilities which were not transferred to the new Olympic Airlines, and specifically the expenditure connected with the early retirement of certain staff, were to be financed out of the special account and from revenue generated by the supply of services to Olympic Airlines and to third parties.

3.4. SPATOSIMO AND PAYMENTS TO AIA

- (47) By letter of 19 January 2004 a complainant, Aegean Airlines, forwarded to the Commission a copy of a letter from the Greek Civil Aviation Authority to the Auditor-General of the State, which had also been sent to the Athens International Airport company AIA (ref. DII/A/28751/11626 of 22 July 2003). It appeared from this letter that Olympic Airways owed the sum of

EUR 26 001 473,33 in respect of the 'tax for the modernisation and development of airports', known as '*spatosimo*', which was levied on passengers by air carriers and was to be forwarded by them to the State.

- (48) It also appeared that the Civil Aviation Authority was seeking payment of this EUR 26 million to it. It therefore appeared that Olympic Airways, the main user of Greek airports, did not pay *spatosimo*, thus obliging the State to find means to aid AIA, which was newly established and was dependant on *spatosimo*. Although Olympic Airways was under an obligation to repay the sums it owed at some time in the future, the Commission suspected that in the meantime it was benefiting as a result of the forbearance of the State, which did not penalise it for late payment, but in fact set up mechanisms whereby the other Greek airports had to contribute in order to compensate for the losses occasioned by the late payment or non-payment by Olympic Airways of the money it owed in *spatosimo*.

4. COMMENTS RECEIVED DURING THE PROCEDURE

4.1. THE GREEK AUTHORITIES' INITIAL COMMENTS

- (49) On 11 June 2004 Greece submitted its response to the initiation of the procedure. It began by explaining that in its opinion the most appropriate solution for Olympic Airways was the privatisation of the various businesses and operations of the group. The privatisation would take place as quickly as practicable and in full compliance with all applicable rules and requirements of Greek and EC law; the Commission would be kept fully informed of developments. Greece explained that privatisation was the most economically advantageous solution for the authorities, as it would generate more money than could be expected if the company were to be liquidated. While acknowledging that the privatisation option would also have social and other non-economic benefits, the Greek authorities emphasised that the economic analysis was the only criterion for deciding on the most appropriate strategy.
- (50) Greece referred to the progress that had already been made in the privatisation process, which had been communicated to the Commission in advance. Greece confirmed that the flight operations of Olympic Airways and Olympic Aviation had been hived off into an existing company, Macedonian, along with a number of intangible assets, such as slots, rights under bilateral agreements, the brand name and logo, and Olympic Airways' goodwill. Macedonian had changed its name and had become Olympic Airlines. Ownership of Olympic Airlines' shares (following a capital increase to accommodate the contribution in kind of the flight operations) had been transferred directly to the Greek State, thus taking Olympic Airlines out of the Olympic Airways group. The new company had been granted all necessary licences and had begun operations on 12 December 2003.

- (51) The Greek authorities further explained that the strategic model for Olympic Airlines was the creation of a viable scheduled air carrier, operating with industry average labour costs, which would be able to take advantage of a number of factors including Olympic Airways' strong brand image, Greece's position as one of the world's 15 favourite tourist destinations, and the 2004 Olympic Games in Athens. New management had been appointed to Olympic Airlines and a thorough review of the business plan was under way.
- (52) Following Olympic Airlines' commencement of operations Olympic Airways had ceased to be an EU licensed air carrier and had been renamed Olympic Airways Services. Olympic Aviation had also ceased flight operations, with the exception of limited general aviation and helicopter services, which were expected to be transferred to the new company.
- (53) With respect to the non-flight operations now regrouped within Olympic Airways Services (ground handling, maintenance and engineering and aviation training), Greece indicated that it intended to privatise these activities also. This was provided for by Law 3185/2003. Any holdings in other companies, such as Olympic Catering and Galileo Hellas, were likewise to be sold. Olympic Airways also had interests in three fuel companies that operated at Athens International Airport, namely Athens Airport Pipeline, Olympic Fuel and Olympic IntoPlane, and it was anticipated that these shareholdings would be sold off in a timely and orderly manner. The sale of these companies would be relatively easy, as they had 'clean balance sheets' and their private shareholders had the right of first refusal to buy them.
- (54) The Greek authorities wanted to clarify a number of issues relating to the restructuring that had been raised when the procedure was initiated.
- (55) With regard to the agreements between Olympic Airways and Olympic Airlines, Greece asserted that all services were provided at market rates and were in accordance with Olympic Airways' generally applicable commercial policy. The Greek authorities undertook to transmit these agreements to the Commission.
- (56) With regard to aircraft leases, Greece stressed that the only aircraft transferred to Olympic Airlines were those fully owned by Olympic Airways. Aircraft leased by Olympic Airways were subleased to Olympic Airlines at market rates, because if the leases had been terminated early Olympic Airways would have had to compensate the lessors for their losses. The operating leases would be assigned directly to Olympic Airlines, thus taking Olympic Airways out of the lease.
- (57) The leases of four Airbus A340-300 aircraft partially covered by State guarantees (up to 45 % of the financing value) would not be assigned to the new company. Olympic Airlines would operate these aircraft on a sublease basis, paying market rates to Olympic Airways. In this way the Greek authorities contended that no State benefit would pass to Olympic Airlines.
- (58) On the State guarantees for these aircraft, it was the contention of Greece that although the 2002 Decision declared that restructuring aid granted to Olympic Airways in several forms (including State guarantees) was incompatible, the Commission had ordered the recovery only of the last tranche of the restructuring aid granted, equal to EUR 41 million (as well as the recovery of unauthorised new aid), on the grounds of legitimate expectation. Greece maintained that as the 2002 Decision did not provide specifically for the recovery (or cancellation) of State guarantees, it allowed their continuation.
- (59) The Greek authorities argued that the transfer of public service obligations was lawful, because the operation of these routes formed an integral part of the flight activities of Olympic Aviation, and the routes continued to be operated with the same aircraft and same personnel as the rest of the network.
- (60) Regarding the alleged new aid to Olympic Airways, the Greek authorities expressed some confusion as to what was meant by 'tax obligations'. The Greek authorities said that the Commission had failed to show that the Greek authorities had 'assisted' Olympic Airways by tolerating the non-payment of certain obligations (not only tax obligations). They argued that it was for the Commission to discharge the burden of proving such an allegation, which it had failed to do. The Greek authorities reiterated that Olympic Airways was subject to the generally applicable Greek law and procedures applicable to all Greek companies in this regard.

- (61) Concerning the alleged non-payment of the *spatosimo* tax, the Greek Government submitted that the relationship between the air carriers, who collected *spatosimo*, and the Civil Aviation Authority, to which they forwarded it, had to be distinguished from the relationship between the Authority and the airports in Greece (including AIA), which received funding from *spatosimo* calculated on the basis of the number of passengers flown. Air carriers collected *spatosimo* from passengers, and forwarded it to the State. *Spatosimo* levied but not paid to the State constituted a debt to the State and was subject to the general provision of the Code for the Collection of Debts owed to the State (KEDE). This was what had happened in the case of the sum of EUR 26 001 473,33 referred to, which Olympic Airways had not paid on time but had paid off subsequently, in instalments, with all the default interest and penalties applicable.
- (62) The collection mechanism was separate from the disbursement mechanism whereby the Greek State (through the Civil Aviation Authority) paid money to the airports. Although the two mechanisms were intended to operate back-to-back, one financing the other, the obligation on the Greek State to pay the airports was not dependant on its ability to collect the sums due from the air carriers. As a result there had been situations where the State had been obliged to grant sums that had not yet been collected. While this was unsatisfactory for the State, it did not amount to State aid, as the air carriers were not released from their obligation to pay (with default interest and penalties). In the particular case referred to when the procedure was initiated, cash flow constraints had obliged the Greek State to alter the percentages of *spatosimo* allocated to particular airports, granting more to AIA (which resulted in a short-term reduction in the payments due to other airports). This was essential, as AIA's financial situation was monitored by the European Investment Bank and commercial lenders; the step was irrelevant to the question whether Olympic Airways paid its dues.
- (63) The Greek State said that this non-payment of the *spatosimo* tax was the only evidence cited by the Commission of the non-payment of Olympic Airways' debts to the State.
- (64) With regard to the special account provided for by Law 3185/2003, the Greek authorities submitted that the advance to Olympic Airways of the sum of EUR 130 312 450 was a measure of a temporary nature, and was something that any prudent market investor would do. When the time came to sell Olympic Airlines, any sums advanced would be repaid to the special account. The Greek authorities further explained that the shares in Olympic Airlines no longer belonged to the Olympic Airways group but to the State. As Olympic Airways had been deprived of the value of its flight division, however, provision for an advance to Olympic Airways which did not exceed the value of its 'lost' property was a proportionate and adequate measure for the purposes of restructuring and privatisation.
- (65) In the event that revenue from the sale of Olympic Airlines was not enough to repay the advance of EUR 130 312 450, the shortfall would be made up from the sale of non-flight operations. Law 3185/2003 provided that the proceeds of the sale of these divisions were to be paid into the special account. In the event that the financial obligations of Olympic Airways exceeded the nominal value of the share capital of the companies to be sold, Greek insolvency law would apply, and creditors could make their respective claims accordingly.
- (66) Any sums from the proceeds of the sale which exceeded the nominal value of the share capital of the companies sold would remain with the State, and could not be used by Olympic Airways. Olympic Airways would have access to the account only in order to meet its severance and retirement obligations and to cover the financial obligations of Olympic Airways and Olympic Aviation during the course of the restructuring and liquidation process.
- (67) The Greek authorities submitted that Law 3185/2003 was an attempt to maximise shareholder value so as to maximise the recovery of the aid and the return on investment. Creditors would not be better protected by a bankruptcy.
- (68) In the alternative, if the Commission were to take the view that the advance was not consistent with what a private market economy investor would have done to maximise recovery and return on investment, the Greek authorities asked the Commission to consider whether in the light of the rescue and restructuring guidelines the advance constituted rescue aid compatible with the common market under Article 87(3)(c). In that event the Greek authorities would submit that the conditions for the grant of rescue aid were met from December 2003 onward, and this would be substantiated by providing business plans and the like.
- (69) On the question of possible aid to the future purchasers of any of the Olympic companies, the Greek authorities wanted to reassure the Commission that they intended to sell Olympic Airlines and any other divisions or businesses at market prices, and in accordance with the applicable Greek and Community law.

(70) The Greek authorities disagreed with the conclusion that in prohibiting any creditors of Olympic Airways from bringing actions against Olympic Airlines the Greek State was seeking to protect Olympic Airlines from the enforcement of the 2002 Decision. They contended that this was not the intention, which was rather to maximise recovery of investment. They explained that the operation of the special account was such as to ensure that amounts up to the nominal value of the shareholding of Olympic Airlines were available to Olympic Airways and its creditors, which ensured an adequate level of creditor protection. Greece emphasised that it was entitled to decide upon the most appropriate means of restructuring and privatisation, and that it was a legitimate step on its part to introduce a safeguard to ensure that Olympic Airways' creditors had at least the same level of protection as they would otherwise have had. This protection of creditors should not be confused with the obligation to recover imposed by the 2002 Decision.

(71) Greece also disagreed with the Commission's conclusion that the creation of Olympic Airlines was not a solution, as Olympic Airlines' viability was not guaranteed: Greece stated that it was confident that Olympic Airlines would be successful.

(72) With respect to the proposed long implementation period for the overall restructuring and privatisation, Greece said that it noted the Commission's concerns, and would try to accelerate the process where practicable. Greece intended to provide the Commission with a new timetable for the implementation of the restructuring and privatisation plan and the subsequent liquidation of Olympic Airways.

(73) On the question of other laws providing Olympic Airways with special exemptions or immunities, Greece reiterated that the provisions of Law 96/1975 granting special privileges to Olympic Airways (in the areas of payment of duties on transactions and exemption from payment of stamp and traffic duties and with regard to State guarantees) had been repealed, and that Olympic Airways was subject to all generally applicable taxes and duties and operated in the context of a free market economy.

4.2. COMMENTS SUBMITTED BY THIRD PARTIES

(74) Following the publication in the *Official Journal of the European Union* of the letter addressed to the Greek authorities, comments were received within the time allowed from two other interested parties.

4.2.1. AEGEAN AIRLINES

(75) The first set of comments was submitted by a Greek air carrier, Aegean Airlines ('Aegean'). Aegean made the following observations.

Preferential terms of payment between Olympic Airways and AIA

(76) Aegean alleged that during the first year of operations at AIA, Olympic Airways had paid less than 30 % of its debts to AIA, that agreements had been reached between AIA and Olympic Airways (which was AIA's largest individual customer, at 35 %), and that two preferred mortgages in favour of AIA had been registered on three Olympic Airways aircraft to secure payment of sums in excess of EUR 29 million plus interest and expenses. Olympic Airways' overdue liability to AIA was estimated by Aegean to be of the order of EUR 70–80 million. Aegean alleged that AIA, which was 55 % State-controlled, had allowed Olympic Airways and Olympic Airlines to incur substantial liabilities, and that similar facilities were not available to other airlines. Aegean estimated that if it had been afforded the same facilities it could have had working capital of EUR 40–50 million at its disposal.

The financial performance of companies within the Olympic Airways group

(77) Aegean stated that Olympic Aviation had recorded losses of EUR 32,2 million, corresponding to 39 % of its revenues of EUR 83 million, despite having received EUR 8,2 million in compensation from the Greek State for 'early relocation' of its activities from Ellinikon airport to AIA. Olympic Aviation's debts to Olympic Airways had grown from EUR 68 million in 2000 to EUR 127 million at the end of 2002. Olympic Airways had not consolidated Olympic Aviation's accounts in 2001 and 2002, and in Aegean's view this was to make the parent company's books look better.

(78) Aegean also advanced some indications of Olympic Airways' profitability in 2003. According to publicly available traffic information, Olympic Airways' traffic had declined by 8 % in 2003, while its load factor had declined by 5 %. The decline was most pronounced on its European network, where there had been a fall of 14,4 %; the number of business passengers had fallen by 26 %. In Aegean's opinion this decline in passenger numbers together with an increasingly difficult market (fuel price increases, increased competition from low-cost carriers) meant that the Olympic Airways group's financial position must have deteriorated through 2003.

Possible subsidisation of Olympic Airlines through non-payment of debts to Olympic Airways Services

(79) Aegean voiced its suspicion that the new company was not paying for the services that it received from Olympic Airways Services, or at least was not paying what it ought to pay.

- (80) According to Aegean the advance of EUR 130 312 450 million lodged to the special account had been exhausted after eight months.
- (81) A new law had been adopted (Law 3259/2004) protecting Olympic Airways Services and Olympic Aviation from having enforcement proceedings brought against them. Under this law no enforcement or interim relief proceedings could be brought inside or outside Greece in respect of the movable or immovable assets of Olympic Airways Services or Olympic Aviation before 28 February 2005. The law seemed to have been adopted because certain creditors had seized an Airbus 300-600 aircraft and were threatening to sell it to settle their claims.
- (82) Aegean complained that the Greek State had awarded Olympic Aviation's public service obligation routes to Olympic Airlines automatically, without a public tender. In addition, all of Olympic Airways' rights in respect of traffic to non-EEA States had been taken over by the new company without any reassessment of the criteria for designation, although other airlines, including Aegean, had expressed an interest in being designated.
- (83) Aegean was of the opinion that the transfer of assets to Olympic Airlines without the corresponding liabilities might be incompatible with both the Treaty and the Greek Constitution.
- (84) According to press reports Macedonian had accumulated tax liabilities of GRD 3,5 billion before it was converted into Olympic Airlines; Aegean alleged that the Greek State had not made any claim against Olympic Airlines in respect of this sum.

4.2.2. RYANAIR

- (85) Comments were also received from the Irish low-cost airline Ryanair. Ryanair made a number of general observations regarding the application of Community State aid rules in Member States other than Greece and in relation to airlines other than Olympic. With regard to the case in hand, Ryanair noted at the outset that it was unable to comment on the letter sent to the Greek Government, because no English translation had been provided.
- (86) Ryanair went on to say that in the original investigation against Olympic Airways the amount of State aid found to have been received by Olympic Airways was over

EUR 1 billion, and yet Olympic Airways had been required to repay only EUR 200 million to the Greek State. Other airlines had been forced to subsidise the failing national carrier through higher airport charges because Olympic Airways had been granted a 'holiday' from these charges. In Ryanair's opinion the continued illegal support given to this failed national airline seriously undermined the potential for new and more efficient operators to enter the market. The creation of a new, debt-free airline was unacceptable; Ryanair wondered whether the procedures in force under Article 4 of Council Regulation (EEC) No 2407/92 of 23 July 1992 on licensing of air carriers⁽¹⁰⁾ had been followed with regard to the application for an operating licence for the new company. In conclusion, Ryanair stated that the Greece should not be permitted to circumvent the rules once again and to continue to prop up its failed national airline.

4.3. GREECE'S REPLY TO THIRD-PARTY COMMENTS

- (87) Greece took the view that the information contained in the comments submitted by third parties was inaccurate and contributed nothing new to the investigation. The Greek authorities repeated that the previous privatisation process for the airline had been terminated on 6 October 2004, and that a new group of advisers had been appointed for the privatisation of both Olympic Airlines and the other businesses or divisions. The new group of advisers had already commenced work, and progress was being made on the 'proposal phase'. An indicative timetable for the privatisation had also been drawn up.
- (88) On the specific comments made by the third parties, Greece replied as follows.

4.3.1. AEGEAN AIRLINES' COMMENTS

- (89) The issue of the alleged preferential treatment of Olympic Airways at AIA had been addressed before in the context of the present State aid investigation, before the Court of Justice (Case C-415/03 *Commission v Greece*), and in other State aid investigations (Case NN 27/1996 *Construction and exploitation of Athens International Airport*). Although AIA was 55 % State-owned, it was operated as a private business independent of State control in its day-to-day operations. It therefore had sole responsibility for the collection of airport charges and for the settlement arrangements for late payment. Of the nine directors of AIA, four were appointed by the State and four by the developers, and the remaining one was an independent. Greece reiterated that it had already clarified the issues relating to late payment of *spatosimo*.

⁽¹⁰⁾ OJ L 240, 24.8.1992, p. 1.

- (90) As regards the possible subsidisation of Olympic Airlines through non-payment of debts to Olympic Airways Services, the Greek authorities stated that all services provided by Olympic Airways Services to Olympic Airlines were provided on market terms and conditions. The Greek authorities provided some documentary evidence of payments made by Olympic Airlines to Olympic Airways.
- (91) More generally, Greece provided documentation in support of its assertion that Olympic Airlines had no payments outstanding with any State entity. It supplied evidence of up-to-date payments to the tax authorities in respect of salaried persons tax (FMY), VAT, airport charges (at AIA and elsewhere), *spatosimo* and social security contributions (IKA).
- (92) Greece stated that the sums in the special account were being used in accordance with Law 3185/2003. The advance paid into the account was a measure of a temporary nature that any prudent market investor would have taken. The advance had been used primarily for salaries in both Olympic Airways and Olympic Aviation, aircraft leasing costs, and early retirement of Olympic Airways and Olympic Aviation staff.
- (93) Olympic Airlines had received no funds from the special account, either directly or indirectly. The Greek authorities also strenuously denied the allegation that when it was established Olympic Airlines had not inherited any liabilities.
- (94) The sum of EUR 130 312 450 had been granted in instalments between 24 December 2003 and 13 May 2004 (a period of less than six months). It was paid out in this way so that if the Commission were to decide that it constituted State aid within the meaning of Article 87(1) of the Treaty, the conditions it needed to meet in order to qualify as rescue aid would all be met. In support of its contention that the advance would qualify as rescue aid, Greece drew attention to the following:
- Olympic Airways was a company in difficulty within the meaning of the rescue and restructuring guidelines;
 - the advance to Olympic Airways constituted liquidity support;
 - the sums advanced in liquidity support were expected to be reimbursed over a period of not more than 12 months after disbursement of the last instalment to Olympic Airways; the last instalment was paid in May 2004, and the reimbursement was to be carried out after privatisation of Olympic Airlines in May 2005;
 - the grant of rescue aid avoided serious and severe social difficulties throughout Greece;
 - Olympic Airways would cease to be an air carrier, and would operate non-flight services only, so that the adverse effects in other Member States would be limited;
 - the amount of the advance was necessary to keep the company in business for the limited period for which it was granted; the amount was proportionate and was comparable to the amounts of rescue aid authorised by the Commission for other undertakings of similar size or undertakings operating in the same industry.
- (95) In Greece's opinion the new law protecting Olympic Airways Services and Olympic Aviation from enforcement proceedings (Law 3259/2004) was necessary to ensure the privatisation process. This temporary measure did not deprive creditors of their rights, but suspended enforcement proceedings for a limited period. The temporary protection from creditors that it provided did not apply against the Greek State or other public bodies, and applied only to Olympic Airways and Olympic Aviation. The measure did not constitute State aid, as it involved no transfer of State resources. (Under Law 3185/2003, following the hive-off creditors would be able to bring proceedings against Olympic Airlines only in respect of debts transferred to Olympic Airlines.)
- Public service obligations and designations under bilateral agreements**
- (96) Greece took the view that the transfer to Olympic Airlines of public service obligations and bilateral designation rights had taken place by virtue of rights of succession in accordance with Greek corporate law. The routes in question had been operated either by Olympic Airways or by Olympic Aviation, and the flight divisions of these companies had been transferred to Olympic Airlines.
- (97) With reference to the allegation that Macedonian had an outstanding tax bill of GRD 3,5 billion, Greece explained that an outstanding tax bill relating to the period 1993-1997 was the subject of litigation in the courts. Including charges and penalties, the amount at issue was EUR 9 106 481,75; the case was still ongoing. Pending the outcome of the proceedings the company had made appropriate provision for the liability in its accounts.

4.3.2 RYANAIR'S COMMENTS

- (98) Greece rejected Ryanair's comments completely: it said that Ryanair was not active on the Greek market, did not compete with Olympic Airlines, and was using the proceedings to advance arguments relating to its own ongoing debate with the Commission.

4.4. COMMENTS SUBMITTED BY GREECE FOLLOWING RECEIPT OF THE LETTER GIVING FORMAL NOTICE OF A SUSPENSION INJUNCTION

- (99) On 11 October 2004 the Commission sent a letter giving Greece formal notice that it proposed to issue a suspension injunction requiring Greece to suspend any illegal aid until a decision could be taken on its compatibility. The letter informed Greece that it intended to adopt such an injunction if within ten days of the date of receipt of the letter it did not receive satisfactory information demonstrating that Greece was no longer making aid payments to the beneficiaries. Greece was asked to submit its comments on the matter.
- (100) The Greek authorities replied to this letter of formal notice on 28 October 2004. Greece argued that issuing an injunction at this stage would be disproportionate and unjustified, and would seriously jeopardise the intensive efforts Greece was making to find a solution to the companies' difficulties. With regard to the substantive issues raised in the Commission's letter, they said that as Olympic Airways was no longer an air carrier it no longer collected the *spatosimo* tax. On the 'special account', and the payment of EUR 130 312 450 to Olympic Airlines from that account, they said this was the act of a prudent investor, or possibly a payment of rescue aid. They could not see the need for a suspension injunction at this stage of the investigation: there had been no significant change in the circumstances since the procedure had been initiated, and there was no evidence of substantial and irreparable damage that might warrant the adoption of such an injunction.

4.5. COMMENTS SUBMITTED BY GREECE FOLLOWING THE JUDGMENT IN CASE C-415/03 COMMISSION V GREECE

- (101) As previously mentioned, the Commission wrote to the Greek authorities on 23 May 2005 seeking information on the measures to be taken by Greece to comply with the judgment of the Court of Justice in Case C-415/03 *Commission v Greece*.
- (102) The Greek authorities replied by letter dated 2 June 2005; that letter was concerned primarily with the issue of recovery following the 2002 Decision, but it will be considered here in so far as touches on

questions relating to the restructuring and proposed privatisation that form the subject matter of the current investigation.

- (103) In the first place, the Greek authorities wanted to raise certain issues relating to the recovery of aid from Olympic Airways. The Greek authorities said that according to paragraph 33 of the Court judgment 'the operation in issue transferred all the assets of the company Olympic Airways ... to the new company Olympic Airlines', but that that was not correct, and that several important assets remained with Olympic Airways, which continued to be active in several markets.
- (104) The companies within the Olympic Airways group were in the process of being privatised, and details of this privatisation had already been given to the Commission departments. The Greek authorities intended to comply fully with the recovery requirement, and when the assets of Olympic Airlines had been sold the proceeds would go directly to the Greek State. If those proceeds were not enough to cover the sums that had to be recovered, use would be made of the proceeds of the sale of Olympic Airways group companies lodged in the special account in the name of the Greek State. Once all these avenues had been exhausted it was the intention of the Greek authorities to liquidate Olympic Airways.
- (105) In the event that the sales from Olympic Airlines were not sufficient to meet the recovery requirement, Greece undertook that no general or special provision of Greek law would protect the 'successor companies' (expressly including Olympic Airlines) from the obligation to reimburse the aid as required by the 2002 Decision. More specifically, regarding the special provision of Law 3185/2003 which granted protection from creditors to Olympic Airlines in respect of debts incurred by Olympic Airways before the restructuring, the letter continued 'not even the Greek State can bring a claim against Olympic Airlines for debts of Olympic Airways', and repeated Greece's view that the primacy of Community law meant that in respect of recovery this provision could not frustrate the application of the Commission Decision and of the Community rules on State aid.
- (106) The Greek authorities said that the purpose of the provision was to protect Olympic Airlines during the restructuring process, rather than to protect it from a possible obligation to recover the aid in accordance with the 2002 Decision. In the event that full recovery could not be made at the level of the Olympic Airways group, a potential future liability for recovery resting with Olympic Airlines would in Greece's opinion not be possible if the successor company was sold at a reasonable market price in the light of the Commission guidelines on privatisation.

5. RESULTS OF THE EXPERT STUDY REQUESTED BY THE COMMISSION

- (107) Before the Commission could assess the points raised when the procedure was initiated, and the information supplied by the Greek authorities and the third parties, it considered it necessary to review the current economic and financial situation of Olympic Airways (Olympic Airways Services) and Olympic Airlines, and the progress that had been made with restructuring and privatisation.
- (108) To this end the Commission engaged the services of independent experts, Moore Stephens, to carry out a study of the restructuring, operations and privatisation to date of the various companies in the Olympic Airways group and to submit its findings on what had happened since the restructuring.
- (109) Moore Stephens ('the experts') carried out their study in Athens between 9 and 26 May 2005. They were facilitated by the Greek authorities and their advisers, and also by the fact that a data room had been prepared by the authorities and their privatisation advisers so that potential purchasers involved in the privatisation process could carry out their own research.

5.1. EXPERT CONCLUSIONS RELATIVE TO THE RESTRUCTURING

- (110) The experts examined the restructuring operation and the way in which the assets and liabilities to be transferred to Olympic Airlines and to remain with Olympic Airways had been evaluated; they indicated that certain entries were not in accordance with either Greek or international generally accepted accounting principles (GAAP). They indicated that a figure of EUR 30 million for goodwill had been recognised on Olympic Airways' balance sheet prior to the restructuring. This figure was a valuation, by management, of the Olympic brand name, the Olympic logo, the Olympic Airlines trademark, and slots and bilateral agreements. Neither Greek nor international GAAP allowed internally generated intangible fixed assets or goodwill to be recognised on the balance sheet.
- (111) Another possible point of concern related to the valuation of aircraft. At the time of the hive-off, aircraft and aircraft engines owned by Olympic Airways and Olympic Aviation had been revalued at current market value. This exercise was carried out at

1 October 2003 by an international airline consultant, Airclaims Ltd, and resulted in an increase of approximately EUR 43,2 million over the existing written-down value.

- (112) The experts pointed out that the opening balance sheet for Olympic Airlines contained no allowance for doubtful debts against trade receivables. Whilst Olympic Airlines management was confident that all the balances transferred would be collected, the experts felt that it was unrealistic to assume zero bad debts. A further figure of EUR 825 020 labelled 'doubtful accounts receivable' was included in Macedonian's conversion balance sheet. The experts were of the opinion that it was imprudent to include this as an asset.
- (113) Olympic Airlines' opening balance sheet contained an asset of EUR 7,9 million from Olympic Airways, estimated by management, which had previously been a debt owed to Macedonian. The corresponding liability had not been transferred to Olympic Airlines because of the provisions of Law 3185/2003 that allowed liabilities to be retained by Olympic Airways.
- (114) The opening balance sheet indicated a sundry debtor item of EUR 24,4 million, which related to a sum due from Olympic Airways in respect of the expected net proceeds of the sale of two A300-600 aircraft owned by Olympic Airways which remained on its balance sheet and which were leased to Olympic Airlines. The inclusion of this item was not in accordance with Greek or international GAAP, as it related to a sale that had not yet occurred of a fixed asset not owned by the company. As Olympic Airlines appeared to have borne the costs and enjoyed the benefits of these aircraft, the aircraft might have been transferred to Olympic Airlines with the other owned aircraft at their book value of EUR 19,2 million.
- (115) The experts confirmed that the Olympic Airlines balance sheet excluded most of the flight operations liabilities of Olympic Airways and Olympic Aviation. Under Greek company law, when activities were hived off as part of a company restructuring all the related assets and liabilities had to be transferred. Whilst there was an inevitable degree of subjectivity in such an exercise, the legislation did not give management the option to be selective in the assets and liabilities transferred. Law 3185/2003, however, contained provisions that permitted the Olympic Airways group management to override the normal requirements of the legislation and selectively to exclude liabilities from the hive-off. Management had taken advantage of Law 3185/2003 to exclude from the hive-off all liabilities over one month old.

- (116) The experts carried out a comparison between the liabilities transferred and those left behind by comparing extracts from the opening balance sheet of Olympic Airlines at 11 December 2003 with the year-end balance sheets of Olympic Airways and Olympic Aviation at 31 December 2003 (Olympic Airways and Olympic Aviation did not prepare balance sheets at 11 December 2003).

BALANCE SHEET EXTRACTS	Olympic Airlines 11 December 2003	Olympic Airways 31 December 2003	Olympic Aviation 31 December 2003	
Provision for termination				
Provision for retirement benefits	33 922 469	82 035 663	10 534 535	Note 1
Other	7 616	89 230 530	709 865	Note 1
	33 930 085	171 266 193	11 244 400	
Long-term debt				
Bank loans	—	148 036 005	—	Note 2/Note 1
Other long-term debt	—	1 018 427	—	Note 1
	—	149 054 432	—	
Short-term liabilities				
Suppliers	31 019 022	89 067 738	148 671 366	Note 1
Banks, short-term liabilities	—	14 504 809	—	Note 3/Note 1
Customers' advances	824 482	—	392 413	Note 1
Taxes and duties payable (including airport duties)	4 045 699	373 549 262	719 901	Note 1
Social security, contributions payable	2 495 142	147 554 360	—	Note 1
Current portion of long-term debt	—	22 986 786	—	Note 2/Note 1
Dividends payable	514 739	—	—	
Amounts owed to affiliated undertakings	—	4 745 844	—	Note 1
Other creditors	7 009 156	65 838 943	617 392	Note 1
Prepaid tickets	32 288 005	—	—	
	78 196 245	718 247 742	150 401 072	
Accruals and deferred income				
Accrued expenses	—	49 642 845	751 674	Note 1
Sundry accruals and deferred income	—	57 328 943	17 664 167	Note 1
	—	106 971 788	18 415 841	
TOTAL LIABILITIES	112 126 330	1 145 540 155	180 061 313	

Note 1: Liabilities retained in accordance with Law 3185/2003.

Note 2: ABN Amro loan.

Note 3: Emporiki Bank loan settled with proceeds EUR 130 million, February 2004.

- (117) The experts showed that no long-term liabilities and less than 10 % of the short-term liabilities had been transferred to Olympic Airlines. The total liabilities transferred to Olympic Airlines (EUR 145 million) were just 9,9 % of the total liabilities of the three companies (EUR 1 471 million). The short-term liabilities transferred to Olympic Airlines (10 % of total short-term liabilities) were those less than one month old.
- (118) The largest liabilities left behind with the Olympic Airways group were tax and social security liabilities to the State amounting to EUR 521 million. The experts reported that in leaving most of the liabilities behind in the Olympic Airways group, Olympic Airlines management's stated intention was to enable the airline, in its new guise as Olympic Airlines, to continue trading and to proceed to privatisation. They concluded that if the Olympic Airways group management had transferred the full liabilities of the flight divisions to Olympic Airlines, the new company would have faced the same liquidity problems as the Olympic Airways group, which would almost certainly have led to the insolvency and closure of the airline. To put it another way, the restructuring exercise would have served no purpose if the full liabilities of the flight divisions of the Olympic Airways group had been transferred with the assets.
- (119) In the case of Macedonian, a tax provision amounting to EUR 9,1 million, relating to the findings of a tax audit covering the years 1992-1997, had been excluded from the balance sheet. No tax provision had been made for Macedonian for the years 1998-2003. A tax department audit had not yet been carried out. Management had not made any provision because they believed there would be no tax liability on profits for the period. Macedonian had made a profit in 2001, 2002 and 2003.
- (120) The experts concluded that the assets transferred to Olympic Airlines had been overvalued. They carried out their own valuation of the assets transferred, and concluded that the figure arrived at by the management of the Olympic Airways group (EUR 130 312 459), which had not been validated by an independent auditor, was significantly overvalued, in their opinion by more than EUR 90 million. Using accounting techniques recognised under Greek and international GAAP the experts restated Olympic Airlines' balance sheet to reflect the issues described above, to the extent that they could be quantified: the result was that the value of the net assets transferred to Olympic Airlines was reduced from EUR 130 million to EUR 38 million. Even allowing for a certain level of subjectivity in the valuation, they said, it was difficult to explain the discrepancy between the two figures; they concluded that Olympic Airlines was overvalued ⁽¹¹⁾.

Item	Opening balance sheet (EUR)	Adjustment (EUR)	Adjusted balance sheet (EUR)	Explanation
1. Goodwill	30 000 000	(30 000 000)	—	Remove internally generated goodwill
2. Owned aircraft	124 599 144	(43 200 000)	81 399 144	State aircraft at written-down value
3. Trade receivables	51 336 137	Management estimate	Management estimate	Remove doubtful trade receivables
4. Amount due from Olympic Airways	7 904 245	(2 904 245)	5 000 000	Restate Olympic Airways debt at actual amount
5. Receivables (Macedonian)	825 020	(825 020)	—	Remove doubtful receivables (Macedonian)
6a. Sundry debtors	24 674 196	(24 674 196)	—	Remove debt relating to future disposal of aircraft
6b. Owned aircraft	—	19 175 961	19 175 961	Include aircraft to be sold at book value
7. Payables > 1 month	—	Management estimate	Management estimate	Include payables > 1 month
8. Tax provision 1992-1997	—	(9 106 482)	(9 106 482)	Include tax provision (Macedonian) 1992-1997
9. Tax provision 1998-2003	—	Management estimate	Management estimate	Include tax provision (Macedonian) 1998-2003
Total		(91 533 982)		

⁽¹¹⁾ The experts observed that this exercise was not an audit of the opening balance sheet, and that the adjustments made did not necessarily include all those that would be required if an audit were to be carried out.

- (121) The experts reported that Olympic Airlines' opening balance sheet and the conversion balance sheets had been compiled by the company's accountants, Deloitte and Touche, from information provided by management, but had not been audited or otherwise independently assessed. Under ordinary Greek company law independent auditors would have to provide an opinion with words to the effect that the figures in the conversion balance sheets were properly extracted from the company's underlying accounting records. However, Law 3185/2003 allowed Olympic Airlines to forgo this exercise, and required only that the auditors draw up the balance sheets, without having to provide an opinion on them.
- (122) The experts could not say whether Deloitte and Touche had indeed drawn up the balance sheets, or whether they had been drawn up by management. Deloitte and Touche's report on their work was a descriptive report explaining the make-up of the balance sheets, in which they emphasised that 'no audit or other independent examination was carried out by ourselves' and that the conversion balance sheets remained 'the full, absolute and exclusive responsibility' of management.
- (123) The experts concluded that in addition to the questions of proper accounting treatment set out in the previous finding, there was an overall lack of assurance over the opening balance sheet figures, because of the absence of an audit or other independent control over the exercise. In support of this conclusion, the experts also referred to the auditors' report on the financial statements of Olympic Airlines for the year ending on 31 December 2003, two and a half weeks after the opening balance sheet, where the auditors expressed reservations in respect of the company's opening balances. The auditors stated that they were not in a position to confirm the value of goodwill, fixed assets at valuation and the debtors and creditors transferred from the component companies to Olympic Airlines, and therefore did not express an opinion on them.
- (124) Law 3185/2003 provided for a cash advance from the Greek State to cover the financial obligations of Olympic Airways and Olympic Aviation in the course of the conversion and liquidation procedure; this sum was based on the nominal value of the shares of Olympic Airlines. The experts concluded that it was in the interests of the Olympic Airways group [...] (*) to maximise Olympic Airlines' opening share capital by maximising the value of transferred assets and minimising the value of transferred liabilities. The value of the net assets transferred and, in turn, the nominal value of the share capital of Olympic Airlines was EUR 130 million. The Greek Government had paid this sum to Olympic Airways in accordance with Law 3185/2003.
- (125) The experts concluded that if recognised accounting practices had been applied, Law 3185/2003 would have permitted the Greek Government to make only a much smaller contribution to Olympic Airways. Considering the cash position of Olympic Airways and Olympic Airlines at the time of the restructuring, such a reduction in the cash available from the Government would have had significant implications for the ability of Olympic Airways and Olympic Airlines to continue trading.
- (126) They further concluded that the final outcome of the hive-off, privatisation and asset sale process was that the Olympic Airways group would be left with no trading activities, with minimal assets and with debts amounting to hundreds of millions of euro. The insolvency rules in Greek law were likely to be applied to Olympic Airways and Olympic Aviation, which would be placed in liquidation. The costs would be borne by the creditors, principally the Greek State.
- 5.2. EXPERTS' CONCLUSION ON OLYMPIC AIRWAYS (OLYMPIC AIRWAYS SERVICES) AFTER RESTRUCTURING
- (127) The experts examined the situation of Olympic Airways (Olympic Airways Services) following on from the Decision of 11 December 2003. The company had continued to make losses, which had eaten away at its capital and reserves and had severely hampered its borrowing possibilities.
- 5.2.1. OLYMPIC AIRWAYS' (OLYMPIC AIRWAYS SERVICES) TAX AND SOCIAL SECURITY SITUATION
- (128) The experts found that Olympic Airways' balance sheet contained large tax and social security liabilities. These had been increasing year on year, as payments to the tax authorities had not matched annual liabilities. The tax liability related mainly to employee payroll tax dating back several years and also included airport tax, VAT and profits tax liabilities. Under the hive-off of flight operations to Olympic Airlines, only one month's tax and social security liabilities had been transferred to the newly created entity. The social security liability related primarily to the company's main pension fund. In 2003 and 2004 the liability had increased by a total of EUR 137 million. In this period the company made payments of EUR 7,7 million under an agreement to settle debts for years prior to 2003.

(*) Covered by the obligation of professional secrecy.

(EUR million)

	2002 (*)	2003 (*)	2004 (**)
Taxes	219	374	431
Social security	54	148	196
Total	273	522	627

(*) Figures from audited financial statements (qualified).

(**) Draft, unaudited figures from Olympic Airways accounting records.
 Note: Figures for 2005 are not available, as Olympic Airways' accounting records have not been updated beyond 31 December 2004.

(129) The experts noted that the Olympic Airways audit report for 2003 stated that the company's books and records had to a great extent failed to comply with the provisions of tax legislation. The audit report also stated that the tax audit for the years 1998 and 1999 had concluded that the books and records were inadequate, and that since the company had not been audited by the tax authorities for the years 2000 to 2003 inclusive, its tax obligations for the years 1998 to 2003, inclusive, were not final.

(130) The experts concluded that Olympic Airways had a history, going back several years, of not paying its taxation and social security liabilities in full. At the end of 2002 the total liability was already large, at EUR 273 million, and it had continued to grow significantly over the period since then. The estimated liability at the end of 2004, at EUR 627 million, was over 75 % of the combined annual turnover of Olympic Airlines and the Olympic Airways group for 2003. They added that the underpayment of tax liabilities by Olympic Airways had provided a cash flow benefit to Olympic Airways both before and after restructuring.

5.2.2. THE EUR 130 312 459 TRANSFERRED TO OLYMPIC AIRWAYS (OLYMPIC AIRWAYS SERVICES)

(131) The Greek Government made cash transfers totalling EUR 130 312 459 to the Olympic Airways group in seven instalments between 24 December 2003 and 13 May 2004. These were examined by the experts to see how they were paid and what they were subsequently used for.

(132) The money was paid under Law 3185/2003, and was based on the nominal value of the share capital in the newly established Olympic Airlines. According to the Law, the sum was 'to cover severance payments and other expenses for the retirement, in whatever manner, of the employees, and to cover the financial obligations of Olympic Airways and Olympic Aviation in the course of the conversion and liquidation.'

(133) The experts found that the transfers had been made at times when Olympic Airways' bank account was short of funds. A pattern was evident in which the State transfers were utilised gradually over a period of weeks as cash receipts from other sources fell short of cash payments out. At the point that the bank account was close to running out of funds, another transfer was made and the process was repeated.

Date of transfer	EUR
24 December 2003	32 960 288
14 January 2004	10 091 143
30 January 2004	35 356 335
13 February 2004	10 000 000
8 April 2004	8 000 000
22 April 2004	12 000 000
13 May 2004	21 904 693
Total	130 312 459

(134) Using this payment schedule and information provided by Olympic Airways, management [...]. The experts ascertained that Olympic Airways management appeared to have interpreted the concept of retirement and other restructuring expenses in the broadest possible sense, so as to cover any kind of spending by Olympic Airways in the period between the hive-off of Olympic Airlines and the completion of privatisation. It was not easy to verify the analysis of the purposes for which Olympic Airways had used the money, because the funds from the special account were not differentiated from any other funds received into the company's main bank account, but Olympic Airways management indicated to the experts that the funds had been spent as follows:

Expense category	EUR
Aircraft leasing	51 012 257
Retirement payments	29 953 077
Payroll	34 407 994
Repayment of loan — Emporiki Bank	14 939 131
Total	130 312 459

5.2.3. REPAYMENT BY GREEK STATE OF PART OF ABN AMRO BANK LOAN TO OLYMPIC AIRWAYS

- (135) On 9 February 2001, Olympic Airways entered into a loan agreement with ABN Amro Bank for a loan of EUR 182 198 160 to finance the relocation of Olympic Airways to the new Athens International Airport.
- (136) The loan was repayable in 16 six-monthly instalments of EUR 11 387 385 each, plus interest, between 9 August 2003 and 9 February 2011, and was backed by a State guarantee that entitled ABN Amro to demand fulfilment of Olympic Airways' payment obligations directly from the State.
- (137) Under the terms of the hive-off of flight operations to Olympic Airlines on 11 December 2003, the loan remained as a liability in Olympic Airways' accounts. By 31 December 2003, Olympic Airways had paid one scheduled instalment of the loan, and the liability in Olympic Airways' balance sheet was EUR 170 810 775.
- (138) In their review of Olympic Airways' accounting records the experts found that ABN Amro had invoked the Government's guarantee in respect of the second, third and fourth instalments of the loan. As a consequence the Greek State had paid the following instalments on behalf of Olympic Airways:

Date of payment	Amount paid (EUR)
10 May 2004	12 390 090 (*)
8 October 2004	12 288 017 (*)
9 March 2005	12 267 250 (*)
Total	36 945 357

(*) Principal plus interest.

- (139) The experts also found that the Government had asked the Greek tax authorities to recover the money from Olympic Airways. The tax authorities had submitted debit notes to Olympic Airways requesting payment. The amount was recorded in Olympic Airways' books as a liability to the tax authorities, but had not yet been repaid.

5.2.4. FINANCE LEASING OF AIRCRAFT (A340s)

- (140) In their review of Olympic Airways' accounts the experts found that on 24 September 2004 the Greek State had made lease payments totalling EUR 11 774 684 as guarantor under two finance lease agreements with Crédit Lyonnais for two A340 aircraft. The payments related to the six-monthly instalment due on 29 July 2004 under the lease contracts for the aircraft.
- (141) The experts found that the Government had asked the Greek tax authorities to recover the money from Olympic Airways. The tax authorities had submitted debit notes to Olympic Airways requesting payment. The amount was recorded in Olympic Airways' books as a liability to the tax authorities, but had not yet been repaid.

5.2.5. DIRECT CASH FUNDING OF OLYMPIC AIRWAYS BY THE STATE

- (142) The experts also found that on 9 August 2004 the Greek State had made a cash payment of EUR 8,2 million to Olympic Airways. This sum had been paid by the State as an advance to Olympic Airways against money that Olympic Airways had paid into an escrow account, as a guarantee for finance lease payments to Crédit Lyonnais for two A340 aircraft. Crédit Lyonnais had agreed to allow the money to be released from the escrow account upon completion of the transfer of the aircraft lease contracts from Olympic Airways to the State (by novation), which was due to happen in December 2004. The transfer of the contracts to the State was indeed completed in December 2004.

- (143) When Olympic Airways had recovered the money from the escrow account in December 2004, it had not repaid the advance from the State. On 23 March 2005 the State wrote to Olympic Airways requesting repayment of the amount, plus interest. At the date of their final report to the Commission, on 14 June 2005, the experts confirmed that Olympic Airways had not repaid the amount to the State.

5.2.6. OTHER EXPENSES

- (144) In their review of Olympic Airways' books, the experts found that the creditor balances at 31 December 2004 showed a sum of EUR 8 million owing to the State-owned Greek Telecommunications Organisation (OTE). Olympic Airways' general ledger showed that Olympic Airways had not paid OTE for services at some locations in 2003 and 2004. Of the balance, EUR 4,5 million related to periods before 2003.

5.3. EXPERTS' CONCLUSIONS ON OLYMPIC AIRLINES AFTER RESTRUCTURING

5.3.1. OLYMPIC AIRLINES' RESULTS IN 2004

(145) The experts found that Olympic Airlines had experienced a difficult trading year in 2004, resulting in an operating loss of EUR 94,5 million on turnover of EUR 616,7 million, and a net loss for the year, before tax, of EUR 87,1 million. Even in terms of gross operating profit (turnover less direct costs of services) the company had achieved a profit of just EUR 4 million. The 2003 profit-and-loss figures included a provision of EUR 13 million as an extraordinary item, of which EUR 12,6 million had been released back to income in 2004. It was therefore more appropriate to view the loss for 2004 as EUR 99,7 million, rather than EUR 87,1 million.

(146) The experts pointed out that the net assets of the company, at EUR 24,3 million, had fallen to 18,6 % of the share capital of EUR 130,4 million at the end of 2004. Furthermore, if the goodwill of EUR 18 million were to be written off, the net assets would be reduced to 4,8 % of share capital. Law 2190, which governed public limited companies, required that when the net worth of a company fell below 50 % of its share capital a shareholders' meeting had to be convened to take measures to restore the company's balance sheet and hence the protection of creditors. That had not happened in the present case. Under the same law, if the net worth of a company fell below 10 % of share capital, the Ministry of Commerce had power to withdraw the company's licence to trade. But the experts said that this measure was a last resort and was rarely taken in practice.

(147) The principal reasons advanced by Olympic Airlines management for this result were:

- a negative response by the tourism market to the restructuring of the Olympic Airways group, resulting in lower bookings in the Christmas 2003/New Year 2004 holiday period;
- cabin crew strikes between December 2003 and February 2004 that resulted in cancelled flights, lower bookings and increased costs during that period;
- additional costs relating to the restructuring, including the need to employ significantly more pilots than envisaged, and higher lease costs and more wet leases than expected.

(148) As Olympic Airlines did not have cash reserves to finance these losses, the experts concluded that its only options were to borrow money or to obtain extended

credit terms from its suppliers. The experts carried out an analysis of the company's cash flow of the company in 2004, and showed that the company had followed the latter course, with creditors increasing by EUR [...] million in the year. Among the most significant increases in the suppliers account there was a sum of EUR [...] million owed to AIA, up from EUR [...] million in 2003. In April 2005, Olympic Airlines entered into a settlement agreement with AIA for the payment of EUR [...] million of the EUR [...] million debt outstanding at that date. The terms of the agreement were for fixed monthly payments to be made between 30 April 2005 and 30 November 2005. Another significant component in the debt owed by Olympic Airlines at 31 December 2004 was a balance of EUR [...] million owed to Olympic Aviation; this had increased from EUR [...] million at 31 December 2003.

(149) As regards the activities of Olympic Airlines in 2005, the experts observed that financial statements were not available for periods after 31 December 2004, but from other financial records and discussions with management they concluded that Olympic Airlines had incurred further losses in the first quarter of 2005. As in previous years, this had resulted in a squeeze on cash flow and had forced management to seek short-term financing solutions. Additional positive cash flow had been generated by the delayed payment of charges to Athens International Airport, and security had been provided in the form of mortgages on aircraft totalling EUR 36 million.

(150) The experts concluded that Olympic Airlines' business was heavily cyclical, as evidenced by the negative cash flow in the months of October to March, which was compensated for by positive cash flow in the months of April to September. This cycle repeated itself each year. The net inflows in the summer months did not compensate in full for the net outflows in the winter months, so that overall there was an ongoing need for additional facilities. It was not clear when the company would become cash-flow positive year on year, but management hoped that under new ownership this would happen in 2006 at the earliest or 2007 at the latest.

5.3.2. TAX (INCOME TAX, CORPORATION TAX, SOCIAL SECURITY AND VAT)

(151) The experts reviewed the accounts, books and records of Olympic Airlines in relation to employee income tax, social security contributions and VAT for the period from December 2003 to May 2005. They observed that under the terms of the hive-off of flight operation to Olympic Airlines, only one month's tax and social security liabilities had been transferred to Olympic Airlines in respect of Olympic Airways staff transferred to the new company.

- (152) The total tax and social security bill owed by Olympic Airlines to the Greek State had increased by EUR 20,2 million between December 2003 and December 2004. This formed part of the EUR 94,4 million owed by Olympic Airlines.
- (153) Employee and employer social security contributions (IKA) were accounted for and paid to the State on time up to October 2004. Between October 2004 and February 2005, payments were not made. In March 2005, the company entered into a settlement agreement with the tax authorities to pay the outstanding debt of EUR [...] million in 18 monthly instalments starting in March 2005; this effectively converted the balance owed into an 18-month loan facility. Since March 2005 the company has complied with this arrangement and with its ongoing monthly obligations.
- (154) The experts found that Olympic Airlines had properly accounted for and paid VAT in the period.

5.3.3. AIRCRAFT

Aircraft type	Number	[...]	Number of seats	Ownership
Airbus A340-313	4	[...]	295	Leased
Airbus A300-65	3	[...]	269	Leased
Boeing 737-400	14	[...]	150	Owned 7/leased 7
Boeing 737-300	2	[...]	136	Leased
Boeing 717-200	3	[...]	100	Leased
ATR-72-320	7	[...]	68	Owned
ATR-42-320	6	[...]	50	Owned 4/leased 2
DHC-8	4	[...]	37	Leased
Total	43			

- (155) The experts reported that Olympic Airlines had commenced operations with a fleet of 43 aircraft, 18 owned and 25 leased. Since that time the number of aircraft owned by Olympic Airlines had remained the same, and the number it leased had fallen by three. Two Airbus A300-600 aircraft owned by Olympic Airways and leased by Olympic Airlines had been sold in February 2005, and the lease of one Boeing 737-3000 had not been renewed when it expired in March 2005.
- 5.3.3.1. **Operating leases**
- (156) Olympic Airlines subleased aircraft from Olympic Airways, Olympic Aviation (Olympic Airways Services) and, in the case of four finance leases, direct from the Greek State (see Section 5.3.3.2). Eighteen aircraft were currently leased on operating leases, either direct from the lessors or subleased from Olympic Airways or Olympic Aviation (Olympic Airways Services). As the leases between the lessors and Olympic Airways and Olympic Aviation (Olympic Airways Services) expired, Olympic Airlines entered into new lease contracts directly with the lessors.
- Airways Services), the sublease charges were lower than those due under the head lease. When they asked Olympic Airlines management why this was and how it could be justified, they were told that the subleases were at market rates. According to Olympic Airlines management, Olympic Airways (Olympic Airways Services) benefited from the arrangement because it had a lessee for its aircraft. Olympic Airlines stressed that it could source its leased aircraft from elsewhere if Olympic Airways did not offer market rates. Olympic Airlines benefited because it was able to lease the aircraft at what it considered to be current market rates rather than the higher rates that had obtained under the original contracts.
- (157) The experts found that where aircraft were subleased from Olympic Airways or Olympic Aviation (Olympic Airways Services), the sublease charges were lower than those due under the head lease. When they asked Olympic Airlines management why this was and how it could be justified, they were told that the subleases were at market rates. According to Olympic Airlines management, Olympic Airways (Olympic Airways Services) benefited from the arrangement because it had a lessee for its aircraft. Olympic Airlines stressed that it could source its leased aircraft from elsewhere if Olympic Airways did not offer market rates. Olympic Airlines benefited because it was able to lease the aircraft at what it considered to be current market rates rather than the higher rates that had obtained under the original contracts.
- (158) The experts carried out a comparison of the head-lease and sublease rates, and found that for the year to 31 December 2004 the total charges for subleases from Olympic Airways to Olympic Airlines amounted to EUR 29,7 million, whereas the total head-lease costs paid by Olympic Airways for the same aircraft over the same period amounted to EUR 67,3 million. The lease cost ultimately borne by Olympic Airways was EUR 37,6 million (55 % of the total lease cost).

5.3.3.2. Finance leases

- (159) The experts reported that following the initial hive-off, four Airbus A340-300 aircraft, the lease for which had been guaranteed by Greece, had initially been subleased by Olympic Airways to Olympic Airlines. However, because of the perceived uncertainty over the future of Olympic Airways and Olympic Airlines at the time of the hive-off, the financial institutions involved (the lessors) had imposed more onerous payment and security conditions for the leases. In order to alleviate those conditions, both for Olympic Airways and for itself as guarantor, the Greek State decided to step into Olympic Airways' shoes, and the head leases for all four aircraft were transferred from Olympic Airways to the State (by novation), two in December 2004 and two in April 2005. The experts observed that in order to be able to do this legally it was necessary for the Greek Parliament to pass new legislation (Article 53 of Law 3283/2004).

Aircraft	Reg. No	Price of head lease Olympic Airways/ State - lessor	Price of sublease Olympic Airways/ Olympic Airlines	Price of sublease State/ Olympic Airlines (after novation)
Airbus A340-300 MSN 280	SX-DFC	EUR 789 648	USD 600 000	USD 600 000
Lease agreement date		8.10.1999	27.5.2004	27.4.2004
Airbus A340-300 MSN 292	SX-DFD	EUR 770 599	USD 600 000	USD 600 000
Lease agreement date		8.10.1999	27.5.2004	25.4.2004
Airbus A340-300 MSN 235	SX-DFA	EUR 744 509	USD 525 000	EUR 395 000
Lease agreement date		8.10.1999	12.12.2003	17.12.2004
Airbus A340-300 MSN 239	SX-DFB	EUR 744 509	USD 525 000	EUR 395 000
Lease agreement date		8.10.1999	12.12.2003	17.12.2004

Note 1: Head lease payments are half-yearly in arrears.

Note 2: Sublease payments are monthly in advance.

Note 3: All payments shown in the table are on a monthly basis.

Monthly head-lease payments are based on annual payments for 2004 divided by 12.

Note 4: All figures exclude interest.

- (160) The experts also carried out a comparison between the head-lease rates and the sublease rates in respect of these four aircraft. They found that the head-lease charges paid by the State amounted to approximately EUR 750 000 per month, whereas the sublease charges ranged from approximately EUR 400 000 to EUR 500 000 per month. In effect the Greek State lost between EUR 250 000 and EUR 350 000 on each of these four aircraft each month.

- (161) The experts also indicated that between December 2004 and the end of March 2005, Olympic Airlines had made no payments to the State for the two A340s the State was subleasing to it. At the end of March 2005, Olympic Airlines' liability to the Government in respect of these two subleases was EUR 5,1 million. Olympic Airlines paid this sum in April 2005, along with the lease cost for that month.

5.3.4. SPATOSIMO

- (162) The experts reported that between December 2003, when Olympic Airlines commenced operations, and 31 December 2004, the airport tax collected by Olympic Airlines from its customers amounted to EUR [...] million, and the amount paid to the tax authorities amounted to EUR [...] million. In March 2004, and from June to September 2004, payments to the tax authorities had been made on time (by the 20th of the month following collection). For the other months between December 2003 and March 2005, payments had been made between one and five months late. The balance at 31 December 2004 was EUR [...] million, which represented about three months' collections. At 31 March 2005, the amount of airport tax due was EUR [...] million, which represented about two and a half months' collections.

5.3.5. CHARGES PAID BY OLYMPIC AIRLINES TO OLYMPIC AIRWAYS SERVICES FOR GROUND HANDLING AND TECHNICAL SUPPORT

(163) As Olympic Airlines comprises only the flight divisions of Olympic Airways and Olympic Aviation, it is unable itself to carry out the ancillary functions essential for the running of an airline (line maintenance, refuelling, ground handling etc.), and has to pay to have these things done. The Commission asked the experts to verify the claim made by the Greek authorities that Olympic Airlines paid market prices for these services, and that the contracts had thus been concluded at arm's length.

(164) The experts reported that a series of seven contracts had been concluded between Olympic Airlines and Olympic Airways Services (including Olympic Aviation and Olympic Catering) for a range of services including ground handling, technical maintenance, cargo and mail handling, storehouse management, accounting support and consulting, human resources training and general flight itinerary programming services, information technology and telecommunications services, and catering. The experts found that in 2004, companies within the Olympic Airways group had provided Olympic Airlines with services to a value of approximately EUR [...] million. The main service contracts between Olympic Airlines and the Olympic Airways group were for ground handling and maintenance services. Olympic Airlines used the Olympic Airways group for [...] % of its ground handling services and for all of its maintenance. The contracted fees for 2004, based on scheduled flight activity, were EUR [...] million for ground handling and EUR [...] million for maintenance.

(165) The Commission's experts examined the rates charged by the Olympic Airways group to Olympic Airlines and to other airlines. The rates charged for ground handling services were lower, but this was attributed by Olympic Airlines management to commercial factors, as Olympic Airlines was the largest customer and received volume discounts. For the catering services it received Olympic Airlines appeared to pay market prices, and for technical maintenance services Olympic Airways charged Olympic Airlines on a basis different to the system it applied to other customers, making meaningful comparison impossible. Olympic Airlines management had stated that, in their view, the rates for all the services supplied by Olympic Airways had been negotiated at arm's length and represented fair market value.

5.3.6. AIA CHARGES

(166) AIA is a 55 % State-owned company responsible for the construction, operation and development of Athens International Airport. Although majority State-owned,

the company is run as a private-sector company under the Airport Development Agreement, and is not subject to the laws on Greek State-controlled entities.

(167) AIA was and is Olympic Airways/Olympic Airlines' largest creditor, with annual charges of approximately EUR 60 million. As AIA costs form such an important component of Olympic Airlines' cost base, it was necessary for the experts to examine the relationship between Olympic Airlines and AIA to determine whether the airline received favourable terms that might amount to indirect State support. The experts determined that Olympic Airlines' liabilities and payments to AIA for the period since it began operations up to 19 May 2005 were as follows:

[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]

(168) The experts reported that AIA imposed charges on airlines for a range of services provided by the airport, including aircraft landing and parking fees, security, and ground handling infrastructure. The charges were levied at standard rates, which were detailed in a document published by AIA in June 2003 setting out guidelines for customers, terms and conditions of use, and a schedule of traffic charges. Standard payment terms were 20 calendar days. Late payment interest was payable at 3 % above Euribor.

(169) The experts learned that in late 2004 Olympic Airlines had entered into a financial settlement agreement with AIA under which Olympic Airlines was entitled to settle invoices from AIA within a period of 45 days instead of the 20 days applicable under AIA's normal payment conditions. The extended payment terms applied from 1 July 2004 to 28 February 2005. As a condition for receiving these extended terms, Olympic Airlines was required to provide security in the form of a mortgage in favour of AIA on two [...] aircraft, up to a maximum amount of EUR [...] million. The liability at 31 December 2004 represented approximately four months' charges, and in May 2005 it represented approximately five months' charges, which is clearly in excess of the 45-day payment terms to be allowed under the financial settlement agreement.

(170) On 22 April 2005, Olympic Airlines entered into a settlement agreement with AIA for the payment of EUR [...] million of the EUR [...] million debt outstanding at that date. This agreement provided for a further EUR [...] million in security. Under this agreement variable monthly payments were to be made between 30 April 2005 and 30 November 2005. Of the EUR [...] million, EUR [...] million would come from revenue from public service obligations. Security of EUR [...] million was provided in the form of preferred mortgages on two [...] aircraft and four engines.

(171) On the basis of this information, the experts were of the opinion that allowing Olympic Airlines to build up debts of EUR [...] million over the winter season, and then to convert them into an 18-month short-term loan to be paid over the summer season, in practice amounted to providing Olympic Airlines with seasonal working capital financing. This financing, together with continued tolerance of late payments, suggested that Olympic Airlines was receiving treatment from AIA that would not be available to other airlines.

6. ASSESSMENT OF THE AID

6.1. LEGAL BASIS OF THE ASSESSMENT

(172) Article 87(1) of the EC Treaty states that 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threaten to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market'.

(173) The concept of State aid encompasses any advantage, direct or indirect, which is financed out of State resources and is granted by the State itself or by any intermediary body acting by virtue of powers conferred on it.

(174) The present Decision relates only to aid granted after the 2002 Decision. It is not concerned with any possible State aid element in any future transaction or transactions in respect of the shares or assets of any of the companies involved.

(175) Article 228 of the EC Treaty provides that 'If the Court of Justice finds that a Member State has failed to fulfil an obligation under the Treaty, the State shall be required to take the necessary measures to comply with the judgment of the Court of Justice.' In the case under consideration, the aid was found by the 2002 Decision to be illegal and incompatible with the common market.

In its judgment in Case C-415/03 *Commission v Greece*, delivered on 12 May 2005, the Court of Justice found that the Member State had not taken the necessary measures.

(176) Article 228(2) of the Treaty provides that 'If the Commission considers that the Member State concerned has not taken such measures it shall, after giving that State [by letter of formal notice] the opportunity to submit its observations, issue a reasoned opinion specifying the points on which the Member State concerned has not complied with the judgment of the Court of Justice'.

6.2. EXISTENCE OF AID

(177) The Commission has made an in-depth analysis of the comments received in the course of the procedure, the observations submitted by Greece, and the experts' study of the restructuring of Olympic Airways and of the behaviour of Olympic Airways and Olympic Airlines since restructuring. The Commission has decided to consider the question whether State aid has been granted under four main headings: (i) the restructuring itself; (ii) whether any other State aid has been given to Olympic Airlines since 2003; (iii) the grant of EUR 130 million to Olympic Airways; and (iv) whether any other State aid has been given to Olympic Airways.

(i) What was the nature of the restructuring of the Olympic Airways group carried out in December 2003?

(178) In drawing up and implementing Law 3185/2003 the intention of the Greek authorities seems to have been to enable the flight divisions of the Olympic Airways group, now absorbed into Olympic Airlines, to continue trading and to proceed to privatisation. The Commission must therefore examine the relationship between Olympic Airways and Olympic Airlines. Olympic Airlines was established out of the flight divisions of Olympic Airways and continues Olympic Airways' core flight operations; it initially took over all of Olympic Airways' aircraft, and currently operates 40 aircraft, compared to the 43 previously flown by Olympic Airways, with the same crews on the same routes. Olympic Airlines has succeeded to the route network, the public service obligation contracts and the rights under bilateral agreements with non-EU countries governing routes previously operated by Olympic Airways. As previously mentioned, Olympic Airlines was established under Law 3185/2003, which deals specifically with the case of Olympic Airways/Olympic Airlines, and confers exemption from the provisions of Greek company law that would ordinarily apply.

- (179) Olympic Airways was heavily indebted, and had previously been found by the Commission to have received illegal and incompatible State aid; the hive-off has removed Olympic Airways' revenue-generating flight divisions, while very few of the corresponding liabilities have been transferred. All long-term debt has been left with the predecessor companies, and of the taxes, social security and other charges payable to the Greek State by the Olympic Airways group only one month's liabilities have been transferred to Olympic Airlines. In addition to the tax liabilities owed directly to the Greek State, Olympic Airways had a liability to AIA of approximately EUR 93 million at the date of the hive-off. Under the terms of the hive-off none of this was transferred to Olympic Airlines; all of it remained with Olympic Airways.
- (180) The Commission also concludes that as the privatisation process envisaged by Law 3185/2003 continues, the already heavily indebted Olympic Airways group will be left with no trading activities, minimal assets, and debts amounting to hundreds of millions of euro. It will therefore be even less likely to repay the incompatible State aid, as it is required to do by the 2002 Decision. It is the intention of the Greek authorities that the rules on insolvency should be applied to Olympic Airways and Olympic Aviation and that they should be liquidated. The costs would be borne by the creditors, principally the Greek State. The Commission observes that both Olympic Airways and Olympic Airlines are owned in their entirety by the Greek State, so that the establishment of Olympic Airlines is not so much a restructuring as an artificial reorganisation within a single group. This understanding of the matter is supported by an examination of Law 3185/203, whereby Olympic Airlines obtains 'protection' from the ordinary provisions of the Greek Civil Code and Commercial Code in respect of debts contracted by Olympic Airways before the hive-off of the flight division. The implication is that in the absence of the special legislation the application of the ordinary domestic law would also lead to the conclusion that there was continuity between the two companies.
- (181) The Commission further observes that the classification of Olympic Airlines as a successor to Olympic Airways was explicitly acknowledged by Greece in its letter to the Commission of 2 June 2005, in which it referred to Olympic Airlines as a 'successor company' to Olympic Airways for the purposes of recovery.
- (182) The Court of Justice has also considered the transfer of assets to Olympic Airlines, which is the essential component in the restructuring, in its judgement in Case C-415/03 *Commission v Greece*. The Court there found that 'the operation in issue transferred all the assets of the company Olympic Airways, free of all debts, to the new company Olympic Airlines ... that operation was structured in such a way as to make it impossible, under national law, to recover the debts of the former company Olympic Airways from the new company Olympic Airlines' ⁽¹²⁾. It added that 'the operation created an obstacle to the effective implementation of Decision 2003/372/EC [the 2002 Decision] and to the recovery of the aid by means of which the Greek State had supported the commercial activities of that company. The purpose of that decision, which aims to restore undistorted competition in the civil aviation sector, was thus seriously compromised'. Thus the Court concluded that the essential aim of the restructuring operation was artificially to insulate the flying divisions of Olympic Airways from what had happened before.
- (183) It is therefore clear that the restructuring of Olympic Airways in 2003 that established Olympic Airlines, while it did lead to the creation of a separate legal entity, was nevertheless carried out so as to avoid recovery under the 2002 Decision, and that Olympic Airlines is a successor company to Olympic Airways at least for the purposes of the recovery of State aid granted before the hive-off.
- (ii) Has Olympic Airlines received State aid since it was established?
- (184) The experts concluded that Olympic Airlines had been losing money since it was established. With regard to the points raised when the procedure was initiated, the experts found that since it was established Olympic Airlines had made all required payments of the *spatosimo* tax; on the issue of ground handling and maintenance services provided by Olympic Airways to Olympic Airlines, the Commission does not have enough information to be able to take a view on whether there is any element of State aid. With regard to tax and social security, the experts found that except for some delayed payments (which had incurred penalties) Olympic Airlines had met its obligations.
- (185) As far as *spatosimo* and tax and social security obligations are concerned, therefore, the Commission concludes that Olympic Airlines has not received State aid since it came into being. However, during their examination of the company's books the experts found that Olympic Airlines had benefited from favourable terms from its suppliers in two respects.

⁽¹²⁾ Paragraph 33 of the judgment.

- (186) Olympic Airlines subleases aircraft from Olympic Airways, from Olympic Aviation and, in the case of four finance leases, direct from the Greek State. The experts showed that in all cases the sublease rates were lower than those charged under the head leases concluded with the head lessors. In the case of the four finance leases, the Greek State was losing between EUR 250 000 and EUR 350 000 on each aircraft each month. In the case of the aircraft subleased to Olympic Airlines by Olympic Airways, the difference between what Olympic Airlines paid and what Olympic Airways paid meant that in 2004 Olympic Airways had lost EUR 37,6 million, or 55 % of the cost of the lease.
- (187) In examining the relationship between Olympic Airlines and AIA, the Commission's experts came to the conclusion that allowing Olympic Airlines to build up debts of EUR [...] million over the winter season, and then to convert them into an eight-month short-term loan to be paid over the summer season, amounted to providing Olympic Airlines with seasonal working capital financing. This financing, together with continued tolerance of late payments, suggested that Olympic Airlines was receiving treatment from AIA that would not be available to other airlines.
- (188) With regard to this favourable treatment the Commission can firstly conclude that the decision by the Greek authorities to sublease aircraft to Olympic Airlines at a loss of between EUR 250 000 and EUR 350 000 per aircraft per month is clearly a transfer of State resources from the State to Olympic Airlines. The measure reduces costs that Olympic Airlines would otherwise have to bear. The measure is specific, in that it is directed solely at Olympic Airlines, and it distorts or threatens to distort competition, in that Olympic Airlines operates in fully liberalised air transport market.
- (189) It is settled case-law that no distinction is to be drawn between cases where aid is granted directly by the State and cases where it is granted by public or private bodies established or appointed by the State to administer the aid⁽¹³⁾. However, for an advantage to be regarded as State aid within the meaning of Article 87(1) of the Treaty it must, first, be granted directly or indirectly through State resources⁽¹⁴⁾, and, second, be imputable to the State⁽¹⁵⁾.
- (190) The Commission has therefore to decide whether the actions taken by Olympic Airways and AIA are imputable to the State. As discussed in paragraph 192 below, the imputability to the State of a measure taken by a public undertaking may be inferred from a set of indicators arising from the circumstances of the case and the context in which that measure was taken.
- (191) With regard to the decision by Olympic Airways to sublease its aircraft to Olympic Airlines at prices significantly below those of the head leases, and by so doing to lose EUR 37,6 million, the Commission observes that the State held 100 % of the shares of both Olympic Airways and of Olympic Airlines. The management and the directors of both companies were appointed by the State. It has to be concluded that Olympic Airways and Olympic Airlines were (and still are) under the control of the State. Greece was able to exercise a dominant influence over both undertakings, both directly and indirectly, as Olympic Airways' largest creditor. Consequently, the decision by Olympic Airways to sublease aircraft to Olympic Airlines was not the act of an independent undertaking.
- (192) With regard to AIA, notwithstanding Greece's insistence that it has no role to play in influencing AIA's commercial behaviour, the Commission observes that the State owns 55 % of AIA's share capital and appoints four of the nine directors. The Court of Justice has indicated other criteria that may be used in determining whether an aid measure taken by a public undertaking is imputable to the State⁽¹⁶⁾. These include 'its integration into the structures of the public administration, the nature of its activities and the exercise of the latter on the market in normal conditions of competition with private operators, the legal status of the undertaking (in the sense of its being subject to public law or ordinary company law), the intensity of the supervision exercised by the public authorities over the management of the undertaking, or any other indicator showing, in the particular case, an involvement by the public authorities in the adoption of a measure or the unlikelihood of their not being involved, having regard also to the compass of the measure, its content or the conditions which it contains'. Although AIA is majority State-owned, it is operated as a private enterprise independent of the Greek State in its day-to-day business (only four of its nine directors are appointed by the State), and given that all debts owed by Olympic Airways/Olympic Airlines to AIA are repaid with interest and have been secured by mortgages on aircraft, the Commission cannot make a definitive finding that the actions of AIA are imputable to the State.

⁽¹³⁾ Case 78/76 *Steinike & Weinlig v Germany* [1977] ECR 595, paragraph 21.

⁽¹⁴⁾ Joined Cases C-72/91 and C-73/91 *Sloman Neptun v Bodo Ziesemer* [1993] ECR I-887, paragraph 19.

⁽¹⁵⁾ Joined Cases 67/85, 68/85 and 70/85 *Van der Kooy and Others v Commission* [1988] ECR 219, paragraph 35.

⁽¹⁶⁾ Case C-482/99 *Commission v France ('Stardust Marine')* [2002] ECR I-4397, paragraph 56.

(193) Accordingly, the Commission finds that the lease arrangements between Olympic Airways and Olympic Airlines distort or threaten to distort competition, because they are specific, in that they favour one undertaking by freeing it from liabilities that it would otherwise have to bear. The Commission also observes that the measures affect trade between Member States and distort or threaten to distort competition in this market, as they involve a Community air carrier, as explained in paragraph 193. The Commission concludes that the lease arrangements whereby Olympic Airlines leases aircraft either from Olympic Airways or from the State constitute a grant of State aid to Olympic Airlines for the purposes of Article 87(1) of the Treaty.

(iii) What was the status of the cash 'advance' from the special account provided for under Law 3185/2003? How was the cash disbursed and spent? Who benefited from the cash disbursements?

(194) The Commission can firstly conclude that this payment is a transfer of State resources (the money comes directly from the State budget and is expressly provided for in Article 27 of Law 3185/2003), and that it is an individual measure, as it is directed exclusively at Olympic Airways.

(195) The Greek authorities contend that the grant of EUR 130 312 459 to Olympic Airways was the act of a prudent investor. According to the relevant Community case-law, the conduct of the State as a public investor has to be compared to that of a notional private investor who is guided by prospects of profitability in the longer term⁽¹⁷⁾. A capital increase needed to ensure the survival of a company which is experiencing temporary difficulties, but which after taking appropriate restructuring measures is in a position to return to profitability, does not necessarily constitute State aid if a private investor would have reached the same conclusion. The Court of Justice has also indicated that there is no State aid where a capital increase takes place on terms that would be acceptable to a private investor operating under normal market conditions⁽¹⁸⁾.

(196) At the time when the sum of EUR 130 312 459 was advanced to Olympic Airways, Olympic Airways was

already in a very difficult financial situation. In the 2002 Decision the Commission had found that the company had received illegal and incompatible State aid, and had ordered that the aid be recovered with interest. Olympic Airways had just been deprived of its flight divisions, and had been left with most of the liabilities which would normally attach to those divisions. At the end of 2003 Olympic Airways owed the Greek State a total of EUR 522 million in unpaid tax and social security liabilities. Given its financial position, the Commission has to take the view that Olympic Airways would manifestly have been unable to obtain a comparable cash advance from a private investor in the same situation. This is so particularly as the 'investor' in the present case was also Olympic Airways' largest creditor, and stood little realistic chance of recovering the sums that Olympic Airways already owed it. Such a creditor would not have allowed a situation where the debts continued to increase while the assets that might have been used to satisfy these debts disappeared⁽¹⁹⁾. On the contrary, a private creditor would have taken all legal steps to obtain payment of the arrears or to enforce its guarantees. The Commission cannot therefore agree with the Greece's contention that advancing the sum in question to Olympic Airways was the act of a prudent investor.

(197) The Commission must then consider whether, as the Greek authorities initially contended, the sum of EUR 130 312 459 can be considered to be a form of compensation to Olympic Airways by the State for the assets which had been taken from Olympic Airways and vested by the State in Olympic Airlines. In order to assess the validity of this argument, the Commission has to examine the value of the assets taken from Olympic Airways and transferred to Olympic Airlines. According to the valuation carried out by Olympic Airways management, the value of the assets transferred to Olympic Airlines amounted to EUR 130 312 459. If this were so, there would be no State aid in the transfer of the money to Olympic Airways, as no advantage would be conferred on Olympic Airways.

(198) The Commission finds it significant here that Olympic's own auditors, Deloitte & Touche, expressed reservations in the annual accounts for the year ending 31 December 2003 with respect to the valuation of assets retained and transferred between Olympic Airways and Olympic Airlines. The auditors stated that they were not in a position to confirm the value of goodwill, fixed assets at valuation and debtors and creditors transferred from the component companies to Olympic Airlines, and therefore did not express an opinion on them.

⁽¹⁷⁾ Case C-305/89 *Italy v Commission* ('Alfa Romeo') [1991] ECR I-1603, paragraph 20.

⁽¹⁸⁾ Joined Cases C-296/82 and C-318/82 *Leeuwarder Papierwarenfabriek* [1985] ECR 3727.

⁽¹⁹⁾ Opinion of Advocate-General Mischo in Case C-480/98 *Magefesa* [2000] ECR I-8717, paragraphs 32 to 43.

- (199) In the study they carried out for the Commission, the experts convincingly demonstrated that the assets transferred to Olympic Airlines had been overvalued. Accordingly, on the instructions of the Commission, the experts carried out their own valuation of the assets transferred, using accountancy techniques and standards which are accepted both in Greece and internationally. They concluded that the value of the net assets transferred to Olympic Airlines was not in the order of EUR 130 million, but instead was approximately EUR 38 million. The Commission has carefully examined the data and methodology used by the experts, and shares their analysis on this point. The Commission concludes that the value of the assets transferred was overstated by approximately EUR 91,5 million.
- (200) Despite the fact that in order to obtain a completely accurate assessment of the amounts concerned there would have to be a full audit of all the assets and liabilities, therefore, the Commission can estimate that the amount overstated is in the order of EUR 91,5 million
- (201) Having decided this point, the Commission observes that the overvaluation is specific, as it expressly provides money directly to Olympic Airways, and that it confers an advantage on the company, as it is to be used 'to cover severance payments and other expenses for the retirement, in whatever manner, of the employees, and to cover the financial obligations of Olympic Airways and Olympic Aviation in the course of the conversion and liquidation' ⁽²⁰⁾ in order to 'cover its financial obligations'. The Commission observes incidentally that this provision was interpreted broadly, and that the sum in question was used to pay for general Olympic Airways operating costs: over EUR 51 million of the sum advanced was used to pay for aircraft leases.
- (202) The Commission also concludes that the measure distorts or threatens to distort competition and affects trade between Member States, as it involves a company which is in competition with other Community companies, especially since the entry into force of Council Directive 96/67/EC of 15 October 1996 on access to the ground handling market at Community airports, where ground handling is declared open to competition in airports with an annual threshold of 2 million passengers or 50 000 tonnes of freight ⁽²¹⁾. The Commission must therefore conclude that the amount by which the assets transferred to Olympic Airlines were overvalued and which has been paid to Olympic Airways amounts to a grant of State aid to Olympic Airways within the meaning of Article 87(1) of the Treaty.
- (iv) Has Olympic Airways (Olympic Airways Services) received State aid since December 2002?
- (203) The experts have shown that since the date of the last Commission Decision concerning Olympic Airways (12 December 2002), and since the split from Olympic Airlines, Olympic Airways has received cash advances from the State, and its tax and social security liabilities to the State have increased.
- (204) It is clear that the repayments of EUR 36 945 357 on the ABN Amro loan, the A340 finance lease payments of EUR 11 774 684 and the direct cash funding of EUR 8,2 million to Olympic Airways involved direct transfers of State resources to Olympic Airways. For the reasons explained in paragraph 7, these measures are new illegal and incompatible aid measures, in so far as they are not a mere execution of guarantees that the Greek State had given previously. As has already been explained in the examination of the 'advance' paid to Olympic Airways, even though the State has registered these amounts with the tax authorities as a claim against Olympic Airways, and even though they are recorded in Olympic Airways' books as tax liabilities, the State stands little or no realistic chance of ever securing their repayment, and thus cannot be said to have been acting in a rational or commercial manner when the payments were made.
- (205) Olympic Airways' (Olympic Airways Services') difficult and deteriorating tax and social security situation has already been described. At the end of 2002 its tax and social security liability was already large, at EUR 273 million. The liability has continued to grow significantly over the period since then. At the end of 2004 the estimated liability was EUR 627 million, so that in the period covered by the present Decision Olympic Airways' liability to the State has increased by EUR 354 million.
- (206) With regard to Olympic Airways' mounting tax liabilities, it is the State itself, through the tax administration, which tolerates the constant deferral and non-payment of various taxes and charges owed by Olympic Airways. Social security contributions are collected by IKA, a public body established by Greek law ⁽²²⁾ which has been made responsible, under State supervision, for managing the social security system and collecting mandatory social security contributions. It has the right to conclude settlement agreements for late payments of debts ⁽²³⁾, but is not required to do so. The ever-increasing tax liability of Olympic Airways to the State is therefore, clearly imputable to the State.

⁽²⁰⁾ Article 27(5)(b) of Law 3185/2003.

⁽²¹⁾ OJ L 272, 25.10.1996, p. 36.

⁽²²⁾ Law 1846/1951, Article 11.

⁽²³⁾ Law 2676/1999.

(207) The Commission must now consider whether this forbearance involves a transfer of State resources. The concept of State aid encompasses not only positive benefits but also measures that reduce normal charges; so that the State's failure to act to enforce its claims clearly does involve such a transfer.

(208) Having established that a transfer of resources imputable to the State has taken place, the Commission must determine whether this aid distorts competition. The Commission takes the view that both the grants of direct aid and the State's failure to act to collect outstanding debts give Olympic Airways a significant commercial advantage over its competitors. In its dealings with Olympic Airways the State has not been acting in a rational and commercial manner. As explained in paragraph 209, there is accordingly a distortion of competition within a liberalised sector of the internal market. The Commission must therefore conclude that both the forbearance of the State concerning Olympic Airways' unpaid and mounting tax and social security liabilities and the payments made by the State in Olympic Airways' place constitute State aid to Olympic Airways within the meaning of Article 87(1) of the Treaty.

6.3. COMPATIBILITY OF THE AID

(i) Compatibility of aid granted to Olympic Airlines

(209) Having reached the conclusion that Olympic Airlines has received State aid since it was established, the Commission must now examine the measures in favour of Olympic Airlines in the light of Article 87(2) and (3) of the Treaty, which provide for exemptions to the general incompatibility declared in Article 87(1).

(210) The exemptions in Article 87(2) of the Treaty cannot apply in the present case: the aid does not have a social character and is not granted to individual consumers, nor does it make good the damage caused by natural disasters or exceptional occurrences, nor is it granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany.

(211) Further exemptions to the general prohibition on State aid are set out in Article 87(3). The exemptions in Articles 87(3)(b) and 87(3)(d) do not apply in this case: the aid does not promote the execution of an important

project of common European interest or remedy a serious disturbance in the economy of a Member State, nor does it promote culture and heritage conservation.

(212) Article 87(3)(a) and (c) of the Treaty provide for the exemption of aid intended to promote the economic development of areas where the standard of living is abnormally low or where there is serious under-employment. Greece is a region falling in its entirety within the scope of Article 87(3)(a).

(213) With regard to aviation services the Commission considers that the objectives of regional aid are as a rule achieved more easily through the imposition of public service obligations. Public service obligations are imposed by the Greek State on companies offering services between islands and between the mainland and the islands, and on some 'thin' routes services are contracted out by the State to an airline that receives compensation for providing them. In general the Commission considers that compensation for public service obligations is necessary, targeted support, and that provided that the operator is chosen by a transparent and non-discriminatory procedure and does not receive overcompensation such State support does not as a rule give rise to issues of incompatible State aid. This was the case with the contracts operated by Olympic Aviation. Under the terms of the restructuring, these routes are now operated by Olympic Airlines as the 'successor' company. Having regard to the limited information at its disposal, the Commission cannot rule out the possibility that the manner in which the public service contracts were transferred from Olympic Aviation to Olympic Airlines failed to comply with the procedures laid down for public service obligations by Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes⁽²⁴⁾. But in any event Greece cannot invoke the exemption in Article 87(3)(a) in respect of the sums granted to Olympic Airlines since its establishment.

(214) Article 87(3)(c) of the Treaty provides for the exemption of aid to facilitate the development of certain economic activities, where such aid does not adversely affect trading conditions to an extent contrary to the common interest, and the Commission must now consider whether this provision can apply to the present case. In carrying out this examination the Commission has to have regard to the applicable guidelines on State aid in the aviation sector⁽²⁵⁾ and State aid for rescuing and restructuring firms in difficulty⁽²⁶⁾.

⁽²⁴⁾ OJ L 240, 24.8.1992, p. 8.

⁽²⁵⁾ 'Application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aids in the aviation sector' (OJ C 350, 10.12.1994, p. 5).

⁽²⁶⁾ OJ C 288, 9.10.1999, p. 2.

- (215) With regard to the aid granted to Olympic Airlines by means of the reduced cost of aircraft leases, the Commission will refer once again to the guidelines on State aid to the aviation sector. Paragraph 14 of the guidelines states that 'Direct aids aimed at covering operating losses are, in general, not compatible with the common market and may not benefit from an exemption' from the general prohibition of State aid. The guidelines go on to specify that direct operational subsidisation of air routes can only be accepted in the case of public service obligations and of aid having a social character granted to individual consumers.
- (216) In the present case the aid granted to Olympic Airlines, either directly by the Greek State through its leases or indirectly via Olympic Airways, cannot fall within either of the acceptable categories of operational subsidisation of air routes. It is also settled law that new aid cannot be compatible with the common market as long as aid which has previously held to be unlawful has not been repaid, since the cumulative effect of the aid measures would be to distort competition in the common market to a significant extent ⁽²⁷⁾. For the reasons set out above, Olympic Airlines is the successor to Olympic Airways' flight division, and therefore its successor for the purposes of recovery, so that new aid to Olympic Airlines cannot be compatible as long as the earlier aid remains unrecovered. Additionally, the grant of aid is an infringement of previous commitments given by Greece not to grant any further aid to Olympic Airways, and by extension to successor companies (Article 1(e) of the 1994 Decision).
- (217) Although the Greek authorities have not argued that the sums received by Olympic Airlines since its establishment arise as a result of the restructuring operation, and even though the Commission has concluded that Olympic Airlines is a successor company to Olympic Airways at least for the purposes of recovery of State aid granted prior to the hive-off, for the sake of completeness the Commission will additionally examine the aid granted to Olympic Airlines in the light of the rescue and restructuring guidelines of 1999. Point 7 of those guidelines states that for the purposes of the guidelines a newly created firm is not eligible for rescue or restructuring aid even if its initial financial position is insecure: this aid is consequently not covered by the guidelines.
- (218) Thus the aid granted to Olympic Airlines since its establishment does not satisfy the tests for exemption under Article 87(3)(c). The Commission finds that Greece has unlawfully granted non-notified new aid to Olympic Airlines by means of the discounted subleases concluded with Olympic Airlines.
- (ii) (a) Compatibility of aid granted to Olympic Airways
- (219) Having concluded that the amount by which the assets transferred to Olympic Airlines were overvalued, and which was subsequently paid by the Greek State to Olympic Airways, amounts to a grant of State aid to Olympic Airways, the Commission must examine the measure in the light of Article 87(2) and (3) of the Treaty, which provide for exemptions to the general incompatibility declared in Article 87(1).
- (220) The exemptions in Article 87(2) of the Treaty cannot apply in the present case: the aid does not have a social character and is not granted to individual consumers, nor does it make good the damage caused by natural disasters or exceptional occurrences, nor is it granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany.
- (221) Further exemptions to the general prohibition on State aid are set out in Article 87(3). The exemptions in Articles 87(3)(b) and 87(3)(d) do not apply in this case: the aid does not promote the execution of an important project of common European interest or remedy a serious disturbance in the economy of a Member State, nor does it promote culture and heritage conservation.
- (222) Article 87(3)(a) and (c) of the Treaty provide for the exemption of aid intended to promote the economic development of areas where the standard of living is abnormally low or where there is serious under-employment. Although Greece is a region that falls in its entirety within the scope of Article 87(3)(a), this provision cannot apply, for the reasons set out in paragraph 211.
- (223) Article 87(3)(c) of the Treaty provides for the exemption of 'aid to facilitate the development of certain economic activities, where such aid does not adversely affect trading conditions to an extent contrary to the common interest', and the Greek authorities have requested the Commission, in the event that it should conclude that the advance is not the action of a market economy investor and therefore has to be seen as State aid within the meaning of Article 87(1) of the Treaty, to consider whether the measure can be considered to constitute rescue aid.

⁽²⁷⁾ Case C-355/95 *Textilwerke Deggendorf v Commission* [1995] ECR II-2265.

(b) Possible rescue aid

- (224) The sum in question was disbursed between December 2003 and May 2004, and the applicable guidelines for deciding on compatibility are therefore the Community guidelines on State aid for rescuing and restructuring firms in difficulty of 1999. Under point 104 of the rescue and restructuring guidelines of 2004 ⁽²⁸⁾, the 1999 guidelines apply where the aid was granted prior to 10 October 2004.

(c) Application of the 1999 rescue and restructuring guidelines

- (225) Point 4 of the 1999 guidelines states that 'There is no Community definition of what constitutes a "firm in difficulty" ... the Commission regards a firm as being in difficulty when it is unable, whether through its own resources or with the funds it is able to obtain from its owners/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to go out of business in the short or medium term.'
- (226) The guidelines go on to say that 'a firm is, in any event and irrespective of its size, regarded as being in difficulty for the purposes of these Guidelines: (a) in the case of a limited company, where more than half of its registered capital has disappeared and more than one quarter of that capital has been lost over the preceding 12 months'.
- (227) Point 6 also states that 'The usual signs of a firm being in difficulty are increasing losses, diminishing turnover, growing stock inventories, excess capacity, declining cash flow, mounting debt, rising interest charges and falling or nil net asset value.'
- (228) The Commission observes that Olympic Airways is a chronically indebted company which has already lost a significant part of its authorised capital. Olympic Airways' debt to the Greek State for tax and social security went from EUR 273 million at the end of 2002 to EUR 522 million at the end of 2003, when the advance was paid to it. As has already been explained, the company has not been able to secure any source of commercial finance, and stands little realistic possibility of being able to pay its debts to the State. The Commission can therefore conclude that Olympic Airways is a firm in difficulty within the meaning of the 1999 rescue and restructuring guidelines.

(d) Conditions for the authorisation of rescue aid

- (229) The 1999 Community guidelines on State aid for rescuing and restructuring firms in difficulty lay down five conditions all of which must be met if rescue aid is to be granted. The Commission must verify whether all of these conditions are satisfied in the present case.
- (230) First, rescue aid 'must consist of liquidity support in the form of loan guarantees or loans. In both cases, the loan must be granted at an interest rate at least comparable to those observed for loans to healthy firms, and in particular the reference rates adopted by the Commission; any loan must be reimbursed and any guarantee must come to an end within a period of not more than six months after the disbursement of the first instalment to the firm'.
- (231) In the present case the rescue aid takes the form of a cash grant (described as an 'advance') of EUR 130 312 450 given by Greece to Olympic Airways and Olympic Aviation, ostensibly to assist these two companies in their restructuring following the hive-off of their flight activities and the establishment of Olympic Airlines. No loan interest is to be charged to Olympic Airways and Olympic Aviation, and it is intended that the sum of EUR 130 312 450 will be paid back to the State directly from the sales proceeds of the privatisation of Olympic Airlines, a company which Greece insists is outside the ownership of the Olympic Airways group. If the sale of Olympic Airlines does not generate sufficient funds to reimburse this 'advance', other assets of Olympic Airways will be sold to make up the difference. In these circumstances it is not possible to conclude that the first condition of the 1999 rescue and restructuring guidelines is met.
- (232) Second, the aid must 'be linked to loans that are to be reimbursed over a period of not more than twelve months after disbursement of the last instalment to the firm'. As indicated above, the sum in question here cannot properly be described as a loan to Olympic Airways and Olympic Aviation, as repayment is contingent on the sale of another company. The sum of EUR 130 312 450 was paid out in instalments, depending on the needs of Olympic Airways and Olympic Aviation, over a period from 24 December 2003 to 13 May 2004. To date, more than a year later, there has been no reimbursement, so the second condition is not satisfied. Given that the measure has failed to satisfy the first two conditions, further examination of the other three conditions would be redundant.

⁽²⁸⁾ OJ C 244, 1.10.2004, p. 2.

(233) The Commission observes that the grant to Olympic Airways in 2003 is also in contravention of previous commitments given by Greece not to grant any further aid to Olympic Airways (Article 1(e) of the 1994 Decision). The Commission takes the view that the measure does not satisfy the tests of rescue aid laid down by the rescue and restructuring guidelines.

(234) The Commission must also consider the other measures which it has decided here amount to State aid, namely the grants totalling almost EUR 57 million given by the Greek State to Olympic Airways, and the forbearance shown by the State towards Olympic Airways, which has seen Olympic Airways' tax and social security liabilities rise from EUR 273 million at the end of 2002, when the restructuring took place, to EUR 627 million at the end of 2004. The exemptions provided for in Articles 87(2) and 87(3)(a), (b) and (d) of the Treaty cannot apply to Olympic Airways (see paragraphs 219 to 221), and the Commission must now assess whether the exemption in Article 87(3)(c) can apply.

(235) As explained above, any new aid to Olympic Airways infringes previous commitments not to grant any further aid (Article 1(e) of the 1994 Decision). More importantly, in considering the new unlawful aid it has to be borne in mind that Olympic Airways has already received aid in the past, so that there is a clear breach of the 'one-time-last-time' principle laid down in the guidelines on State aid to the aviation sector and State aid for rescuing and restructuring firms in difficulty. The Commission also observes that in accordance with the case-law of the Court of Justice new aid cannot be compatible with the common market as long as aid which has previously held to be unlawful has not been repaid⁽²⁹⁾. The new aid granted here, therefore, does not satisfy the tests for exemption under Article 87(3)(c).

(236) The Commission concludes that by overvaluing the assets transferred to Olympic Airlines Greece has granted illegal and incompatible State aid to Olympic Airways to the amount of the overvaluation. It also finds that the grants totalling almost EUR 57 million to Olympic Airways and the Greek State's tolerance of late payment and non-payment of Olympic Airways' tax and social security liabilities constitute illegal and incompatible State aid.

7. LEGITIMATE EXPECTATIONS AND STATE GUARANTEES

(237) Greece made several repayments in respect of the four finance leases on A340-300 aircraft and the loan from

ABN Amro; the guarantees for these loans from the State to Olympic Airways predate the 2002 Decision. Greece contends that the 2002 Decision did not explicitly call for the suspension or termination of guarantees granted by the Greek State to Olympic Airways after 1998, and that this implicitly means that the Commission accepted their continuation and any payments made under them. The Commission cannot accept this assertion, for the following reasons.

(238) The Commission is of the opinion that the substantive provisions of the 2002 Decision were sufficiently clear and unambiguous: 'Article 1. The restructuring aid granted by Greece to Olympic Airways in the form of ... (b) new loan guarantees totalling USD 378 million for loans to be contracted before 31 March 2001 for the purchase of new aircraft and for investment necessary for the relocation of Olympic Airways to the new airport in Spata ... is considered to be incompatible with the common market within the meaning of Article 87(1) of the Treaty'.

With regard to the obligation to recover, the 2002 Decision distinguished between the period 1994–1998 and the period 1998–2002. As far as the period 1994–1998 was concerned, the Commission decided under Article 14(1) of Regulation (EC) No 659/1999⁽³⁰⁾ that no recovery was necessary for aid granted before 14 August 1998. But the State granted the guarantees at issue here well after that date (in October 1999 for the four aircraft and in February 2001 for the ABN Amro loan).

(239) In any event, the Commission points out that if a measure is to constitute the mere execution of a claim under a State guarantee given previously, rather than a grant of new aid, it must comply fully with the terms of the original guarantee (such as the identity of the beneficiary, the deadlines, the amount covered, the need of a prior declaration of bankruptcy, etc.). If a Member State makes a payment in respect of a guaranteed loan under conditions other than those initially agreed at the granting stage, the Commission will regard the payment as new aid which has to be notified under Article 88(3)⁽³¹⁾.

(240) For the sake of precision, it appears that the payments recently made by the Greek State in respect of the above-mentioned loans did not comply with the conditions laid down in the original guarantees as described by the Greek authorities at the time. For instance:

⁽²⁹⁾ Case C-355/95 *Deggendorf*, cited above.

⁽³⁰⁾ 'The Commission shall not require recovery of the aid if this would be contrary to a general principle of Community law.'

⁽³¹⁾ See the Commission notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (OJ C 71, 11.3.2000, p. 14).

— As regards the ABN Amro loan, the Government paid instalments of around EUR 36 million direct, in place of the undertaking, without a prior default and without a prior legal declaration of bankruptcy or insolvency. The fact that the Government subsequently asked the company to pay the money back shows that the payment was not a mere execution of claims under a guarantee granted in the past.

— The same considerations apply to the loans relating to the aircraft finance lease payments of around EUR 11 million and to the direct cash funding of around EUR 8 million.

— Moreover, the loan contracts for the four aircraft were formally amended (by novation) so that the State replaced the undertaking as recipient of the loans. These very substantial changes predated the payments at issue here.

— The advance of EUR 8 million pending the amendment of two of the lease contracts was clearly not a measure envisaged in the original guarantee.

(241) In so far as there were changes, and in so far as the changes were never notified to the Commission nor approved by the Commission, these payments clearly constitute new unlawful aid. When this Decision is being enforced, however, the Commission is prepared to examine any further submissions that may be made by the Greek authorities concerning the payment of around EUR 36 million of the instalments of the ABN Amro loan or the payment of around EUR 11 million under the lease contract for the acquisition of the four aircraft, and the compatibility or otherwise of all or part of these payments with the terms of the original guarantees,

HAS ADOPTED THIS DECISION:

Article 1

1. The acceptance by Olympic Airways and by Greece of aircraft sublease payments from Olympic Airlines which are lower than the amounts paid under the head leases, resulting in losses borne by Olympic Airways in the order of EUR 37 million in 2004 and by the State in the order of EUR 2,75 million up to May 2005, constitutes illegal State aid to Olympic Airlines that is incompatible with the Treaty.

2. Greece has granted illegal and incompatible State aid to Olympic Airways to the amount by which it overvalued the assets of Olympic Airlines when Olympic Airlines was estab-

lished; this figure is provisionally estimated by the Commission to be approximately EUR 91,5 million.

3. The granting by the Greek State to Olympic Airways of sums totalling approximately EUR 8 million, and the additional payment by the Greek State of certain bank loan and finance lease instalments in place of Olympic Airways, between May 2004 and March 2005, to the extent that these payments do not constitute the mere execution of a claim under the guarantees referred to in Article 1(b) of Decision 2003/372/CE and of the related conditions, constitutes illegal State aid to Olympic Airways that is incompatible with the Treaty.

4. The continued forbearance of the Greek State towards Olympic Airways in relation to tax and social security debts to the State amounting to some EUR 354 million between December 2002 and December 2004 constitutes illegal State aid to Olympic Airways that is incompatible with the Treaty.

Article 2

1. Greece shall recover from the recipients thereof the aid referred to in Article 1.

2. Recovery shall be effected without delay and in accordance with the procedures of national law provided they allow the immediate and effective enforcement of this Decision. The aid to be recovered shall include interest from the date on which it was at the disposal of the recipient until the date of its recovery. Interest shall be calculated on the basis of the reference rate used for calculating the grant equivalent of regional aid.

Article 3

Greece shall immediately suspend all further payments of aid to Olympic Airways and Olympic Airlines.

Article 4

Greece shall inform the Commission within a period of two months from the date of notification of the present Decision of the measures taken to comply with Articles 2 and 3.

Article 5

This Decision is addressed to the Hellenic Republic.

Done at Brussels, 14 September 2005.

For the Commission
Jacques BARROT
Vice-President

COMMISSION DECISION

of 28 October 2009

on the State aid C 16/08 (ex NN 105/05 and NN 35/07) implemented by the United Kingdom of Great Britain and Northern Ireland — Subsidies to CalMac and NorthLink for maritime transport services in Scotland

(notified under document C(2009) 8117)

(Only the English text is authentic)

(Text with EEA relevance)

(2011/98/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provision(s) cited above ⁽¹⁾ and having regard to their comments,

Whereas:

1. PROCEDURE

- (1) By letter of 19 December 2003, the United Kingdom informed the Commission of the steps that the Scottish Executive intended to take in order to bring Scottish ferry services 'into line with [their] understanding of the European rules in relation to maritime State aids'.
- (2) By letters of 19 April and 30 June 2004, the United Kingdom informed the Commission of the intention of the Scottish Executive to carry out two public tenders for contracts to provide transport services to the northern and western islands.
- (3) The Commission has since received several formal complaints and informal comments from interested parties regarding alleged incompatible State aid granted to the undertakings which operate those transport services ⁽²⁾.
- (4) Following these complaints, the Commission sent several requests for further information to the United Kingdom pursuant to Article 5 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 (now Article 88) of the EC Treaty ⁽³⁾ (hereinafter 'the Procedural Regulation') to which answers were provided.
- (5) On 16 April 2008 the Commission decided to initiate the formal investigation procedure regarding State aid

measures related to NorthLink Ferries Limited, Cowal Ferries Limited and CalMac Ferries Limited ⁽⁴⁾.

- (6) On 16 July 2008 the United Kingdom sent its observations in reply to the decision to initiate the formal investigation procedure. By letters of 22 December 2008 and 2 February 2009 the United Kingdom provided additional information.
- (7) The Commission received comments from several interested parties following the publication of the decision to initiate the formal investigation procedure. The United Kingdom was invited to respond to those comments.
- (8) On 11, 12 and 13 December 2008, the Commission met with representatives of several interested parties: NorthLink Ferries Limited, Cowal Ferries Limited, CalMac Ferries Limited, Pentland Ferries, Western Ferries (Clyde) Limited, Orkney County Council, Argyll and Bute Council, Inverclyde Council, Scottish Ministers and Scottish Executive and Peer Pressure Group.
- (9) On the basis of the additional information received during the formal investigation procedure, the Commission concluded that part of the scheme constituted existing aid. It therefore decided to initiate, in parallel to the formal investigation procedure, the cooperation procedure foreseen pursuant to Article 17 of the Procedural Regulation.
- (10) On 17 March 2009 the Commission met with representatives of the United Kingdom. In this meeting, in accordance with Article 17 of the Procedural Regulation the Commission informed the Member State that it considered part of the scheme to constitute existing aid and expressed its preliminary view that some aspects of the scheme were no longer compatible with the common market. The Member State's authorities were given the opportunity to submit their comments on this preliminary view both at the meeting and later in written form.
- (11) On 23 March 2009, the Commission requested additional information from the United Kingdom. That information was provided on 15 May and 3 July 2009.

⁽¹⁾ OJ C 126, 23.5.2008, p. 16.

⁽²⁾ Leading to the creation of two cases with references NN 105/05 and NN 35/07.

⁽³⁾ OJ L 83, 27.3.1999, p. 1.

⁽⁴⁾ See footnote 1.

2. DESCRIPTION

- (12) The case concerns the provision of regular ferry shipping services between the Scottish mainland and the islands off the west and north coasts of Scotland. These services are currently mainly provided under public service contracts ⁽⁵⁾ and the operators benefit from compensation for their performance.
- (13) Since the legal frameworks governing the public services provided in the western and northern islands are different and the beneficiaries are separate legal entities, the western islands and northern islands routes are treated separately in the remainder of the current Decision.

2.1. WESTERN ISLANDS

2.1.1. MARITIME ROUTES

- (14) The existing ferry routes in the western Scottish islands are set out in Map 1.

Map 1

Maritime routes in western Scotland



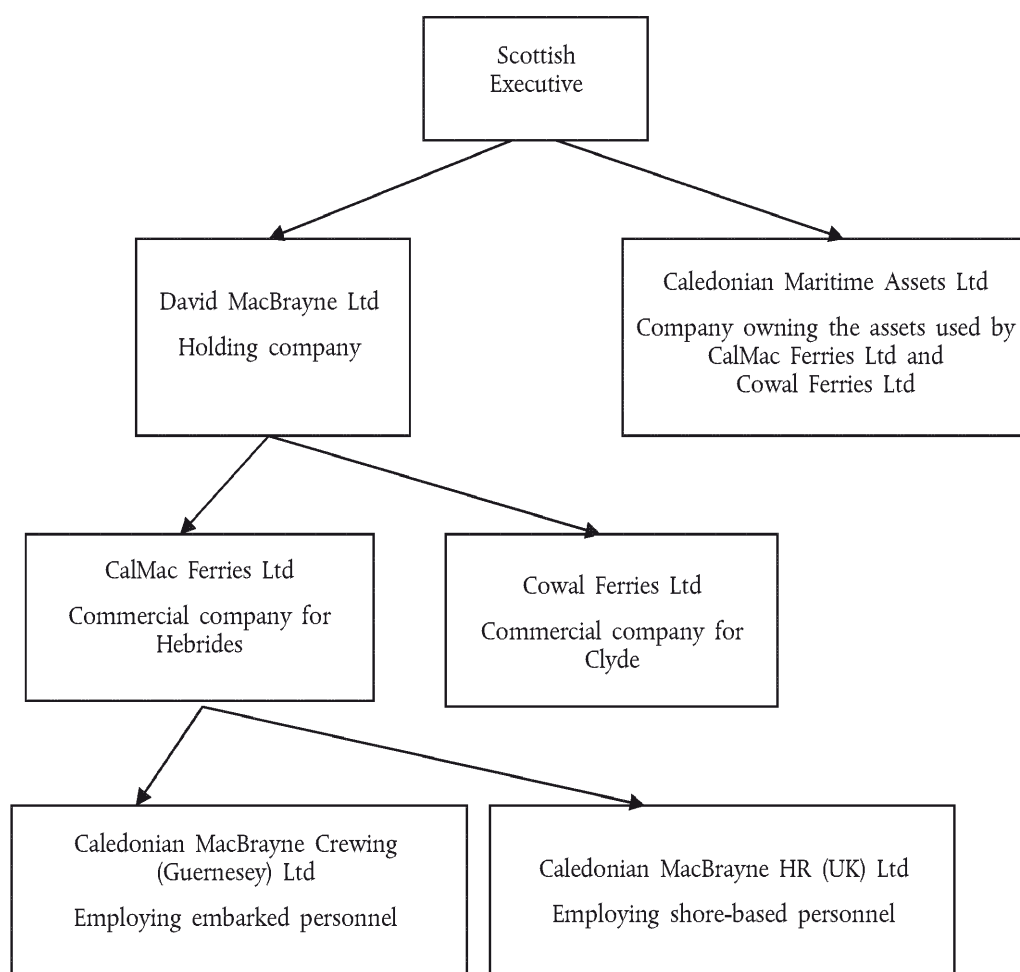
⁽⁵⁾ With the exception of the Gourock-Dunoon route.

2.1.2. OPERATORS

2.1.2.1. **CalMac Ferries Ltd**

- (15) In the 1950s, passenger, mail and cargo coastal shipping services in the western islands ⁽⁶⁾ were dominated by two publicly-owned companies: Caledonian Steam Packet Company Ltd and David MacBrayne Ltd.
- (16) In 1973, Caledonian Steam Packet Company Ltd was merged with part of David MacBrayne Ltd to form Caledonian MacBrayne Ltd. The new company was made responsible for most of the regular shipping services on the Firth of Clyde and the West Highlands and Islands.
- (17) Before 2006 Caledonian MacBrayne Ltd was wholly owned by the State, under the responsibility of the Secretary of State for Scotland, and, after devolution in 1999, by the Scottish Executive.
- (18) In October 2006 Caledonian MacBrayne Ltd was restructured to separate the vessel and shore asset ownership role from the ferry-operating role. The new structure is shown in Chart 1:

Chart 1

Current ownership structure

- (19) The ferry service operations were transferred to two new companies, CalMac Ferries Ltd and Cowal Ferries Ltd, which were created as two wholly-owned subsidiaries of David MacBrayne Ltd. The latter was previously a dormant company fully owned by the Scottish Executive.

⁽⁶⁾ The inner and outer Hebrides and the islands of the Firth of Clyde.

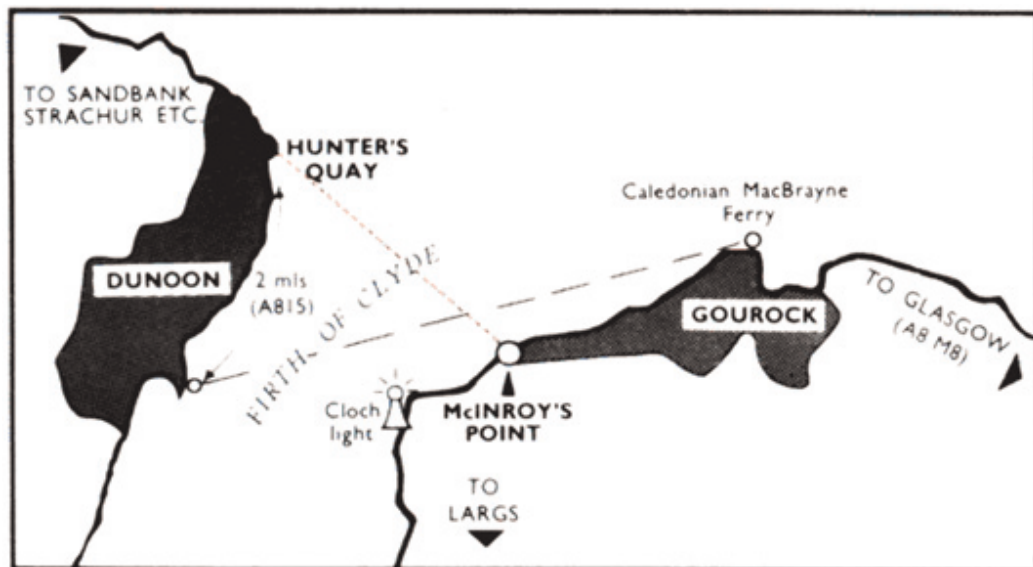
- (20) CalMac Ferries Ltd took over the services to the Hebrides, along with two wholly-owned subsidiaries, Caledonian MacBrayne Crewing (Guernsey) Ltd and Caledonian MacBrayne HR (UK) Ltd, which employ respectively embarked and shore-based personnel.
- (21) Cowal Ferries Ltd took over the services on the Clyde.
- (22) In parallel, Caledonian Maritime Assets Ltd (hereinafter 'CMAL') retained ownership of the vessels and piers that are used for the operation of the Clyde and Hebrides ferry services.
- (23) Under the new arrangements, CMAL leases the vessels and piers to CalMac Ferries Ltd and Cowal Ferries Ltd. It also owns and operates the port facilities in nearly half of the 50 destinations that CalMac Ferries Ltd and Cowal Ferries Ltd serve. CMAL is wholly and directly owned by the Scottish Executive.
- (24) CalMac Ferries Ltd at present charters a fleet of 29 vessels from CMAL to provide passenger, vehicle and shipping services to the islands off the West Coast of Scotland and in the Clyde estuary. Two other vessels are kept on separate charters.
- (25) Cowal Ferries Ltd also charters its three vessels from CMAL.
- (26) Given that the various companies referred to above belong to the same group and for simplicity, for the remainder of the current Decision the term 'CalMac' will be used indistinctively to refer to the companies owned by David MacBrayne Ltd and, in the period prior to the restructuring, to Caledonian MacBrayne Ltd, Caledonian Steam Packet Company Ltd and David MacBrayne Ltd.
- (27) There are currently 26 routes within the network served by CalMac. As regards CalMac Ferries Ltd alone, in the year ended on 31 March 2006, it transported 5,3 million passengers, 1,1 million cars, 94 000 commercial vehicles and 14 000 coaches on these routes.

2.1.2.2. *Western Ferries Ltd*

- (28) CalMac has virtually no competition on the routes it serves. Its sole competitor, Western Ferries Ltd, operates only on the Clyde estuary between Gourock, located in the Upper Firth of Clyde, and Dunoon, located in the Cowal peninsula of Scotland as illustrated in Map 2.

Map 2

Maritime routes in the Clyde estuary



- (29) Western Ferries started operating on the Gourock-Dunoon route in 1973. It currently has four vehicle/passenger vessels doing several daily services and accounts for around 88 % of car traffic, 86 % of freight traffic and 68 % of passenger traffic ⁽⁷⁾.

⁽⁷⁾ Data provided by Western Ferries Ltd.

2.1.3. PUBLIC SERVICE OBLIGATIONS

- (30) The general legal framework allowing for financial support for the performance of ferry transport services in Scotland is the Highlands and Islands Shipping Services Act of 1960⁽⁸⁾ as amended by Section 70 of the Transport (Scotland) Act 2001⁽⁹⁾ and by Section 45 of the Transport (Scotland) Act 2005⁽¹⁰⁾. This legal framework was complemented by 'undertakings' by the Secretary of State with the agreement of CalMac⁽¹¹⁾.
- (31) The legal framework is very general. It merely states that the Scottish authorities may make advances by way of grant or loan to persons for purposes relating to transport. It does not specify in detail the conditions for making such advances. The 1995 undertaking provides for grants and loans to CalMac for the performance of sea transport services to maintain or improve economic or social conditions in the Highlands and Islands. Revenue grants are intended to cover operating deficits while capital grants and loans are intended for investment purposes, such as the acquisition of vessels and works on piers and harbours.
- (32) All the details of the public service, such as the routes qualifying for support, regularity, frequencies, capacities, fare rates and subsidy amounts, were decided by the Scottish authorities and communicated to CalMac via annual letters.
- (33) In October 2006, the last 1995 undertaking lapsed with the restructuring of CalMac. No further undertaking was signed from then until September 2007, when the current 2007 public service contract entered into force.
- (34) Since September 2007 CalMac has been providing ferry transport services under the 2007 public service contract following its winning bid in a public tender procedure⁽¹²⁾ (V-Ships was the only other bidder which later withdrew from the process). The 2007 public service contract covers all routes operated until then by

CalMac, with the exception of Gourock-Dunoon, and specifies in detail the public service obligations to be met. The services include passenger, car and freight transport. The vessels used to provide the services are leased from CMAL, the company created in October 2006 and whose only activity is the ownership and lease of the vessels.

- (35) In 2005-2006 a public tender for the Gourock-Dunoon route was launched, seeking operators to run an unrestricted and unsubsidised service. Three companies manifested an interest in the initial phase (Western Ferries, CalMac and V-Ships) but eventually no company submitted a bid.
- (36) Until the 2007 public service contract entered into force, the compensation for the operation of the Gourock-Dunoon route was not distinguished from the compensation paid for the other routes, as there was one single payment in block, with no hypothecation to individual routes. Since the entry into force of the 2007 public service contract, the subsidy for the Gourock-Dunoon route is paid separately to CalMac.
- (37) The public service obligations for that route and the respective compensation are intended for the transport of passengers only, commercial vehicles being excluded. However, CalMac is free to provide transport services for commercial vehicles on purely commercial terms.
- (38) Since the Gourock-Dunoon route was excluded from the 2007 public service contract, the legal basis for the compensation related to this route continues to be the Highlands and Islands Shipping Services Act of 1960 as amended by Section 70 of the Transport (Scotland) Act 2001 and by Section 45 of the Transport (Scotland) Act 2005.
- (39) There has been considerable continuity over the years in the routes operated by CalMac in the western islands. Nevertheless, some changes have occurred by decision of the Scottish authorities, such as the closing of one route following the opening of a bridge, new services in existing routes and increased frequencies. Capacities have in general increased through the replacement of old vessels by new ones, generally offering larger capacity than the vessel being replaced⁽¹³⁾. In general, tariffs have increased in line with inflation⁽¹⁴⁾.
- (40) CalMac has so far received the following payments from the Scottish authorities relating to those public service obligations:

⁽⁸⁾ The text of this Act is available at the following internet address: http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1960/ukpga_19600031_en_1

⁽⁹⁾ The text of this Act is available at the following internet address: http://www.opsi.gov.uk/legislation/scotland/acts2001/asp_20010002_en_1

⁽¹⁰⁾ The text of this Act is available at the following internet address: <http://www.opsi.gov.uk/legislation/scotland/acts2005/20050012.htm>

⁽¹¹⁾ These 'undertakings' were commitments from the Secretary of State to finance the ferry services with the consent of the Treasury and the agreement of CalMac. Several undertakings were signed in 1961, 1973, 1975 and 1995, each reflecting earlier company structures with the responsibility for services that later formed the basis for the Clyde and Hebrides Ferry Services contract of 2007. The text of the 1995 undertaking is available at the following internet address: <http://www.calmac.co.uk/policies/undertakingbysecretaryofstate.pdf>

⁽¹²⁾ The text of the invitation to tender is publicly available at the following internet address: <http://www.scotland.gov.uk/Resource/Doc/161181/0043718.pdf>

⁽¹³⁾ Eleven vessels have been added to the fleet since 1995.

⁽¹⁴⁾ Since 1995 rates have increased in the range of 2 % to 5 % per year.

Table 1

Public money granted to CalMac since 1995

(GBP million)

	Deficit grants	Capital grants/loans ⁽¹⁾	Total
1995/1996	8,3	8,5	16,8
1996/1997	11,7	2,3	14,0
1997/1998	10,5	9,9	20,4
1998/1999	14,4	11,9	26,4
1999/2000	15,0	9,7	24,7
2000/2001	19,0	6,5	25,5
2001/2002	20,4	1,8	22,2
2002/2003	18,9	7,7	26,6
2003/2004	25,9	2,8	28,7
2004/2005	25,1	8,8	33,9
2005/2006	31,4	6,2	37,6
2006/2007	34,2	9,9	44,1
2007/2008	40,5	4,9	45,3

⁽¹⁾ Loans are net of loan repayments. Until 2002, new vessels were funded through a combination of grants (75 %) and loans (25 %). Since 2002, all vessels have been funded exclusively through loans.

- (41) With regard to the Gourock-Dunoon route, the United Kingdom have provided financial information showing the net turnover of the public service activities (mostly passenger transport) and of the commercial activities (mostly vehicle service) carried out by CalMac since the 2002/2003 financial exercise:

Table 2

Profit and loss account of public service and commercial activities of CalMac in the Gourock-Dunoon route since 2002/2003

(GBP million)

	Public service activities			Commercial activities			Total
	Revenues	Expenses	Profit/Loss	Revenues	Expenses	Profit/Loss	Profit/Loss
2002/2003	0,7	- 3,1	- 2,4	1,0	- 0,5	0,5	- 1,9
2003/2004	0,7	- 3,4	- 2,7	0,8	- 0,5	0,3	- 2,4
2004/2005	0,8	- 3,4	- 2,7	1,0	- 0,5	0,5	- 2,2
2005/2006	0,9	- 3,8	- 2,9	0,9	- 0,5	0,4	- 2,5
2006/2007	0,9	- 3,7	- 2,8	1,0	- 0,5	0,4	- 2,4
2007/2008	0,9	- 3,7	- 2,7	1,0	- 0,5	0,5	- 2,3

- (42) The amounts indicated in the table 2 result from an analytical accounting exercise on the basis of the statutory accounts. Commercial revenues are mostly vehicular revenues and revenues from the respective passengers ⁽¹⁵⁾. Public service revenues are mostly from foot passengers. On the expenditure side, common costs such as personnel, vessel and terminal costs related to mixed passenger-vehicle vessels, are split according to average vessel capacity use for vehicles and for foot passengers.

⁽¹⁵⁾ It is assumed that, on average, two people travel with each car. The number of 'vehicular' passengers as a proportion of total passengers is applied to the total passenger revenue in order to calculate passenger revenue for commercial activities as opposed to public service activities.

- (43) Agreed procedures have been carried out by the Company Auditor (KPMG LLP) on the methodology, accounting detail and statement content. No significant differences were found between the amounts reported in table 2 above and the underlying books and records of CalMac.

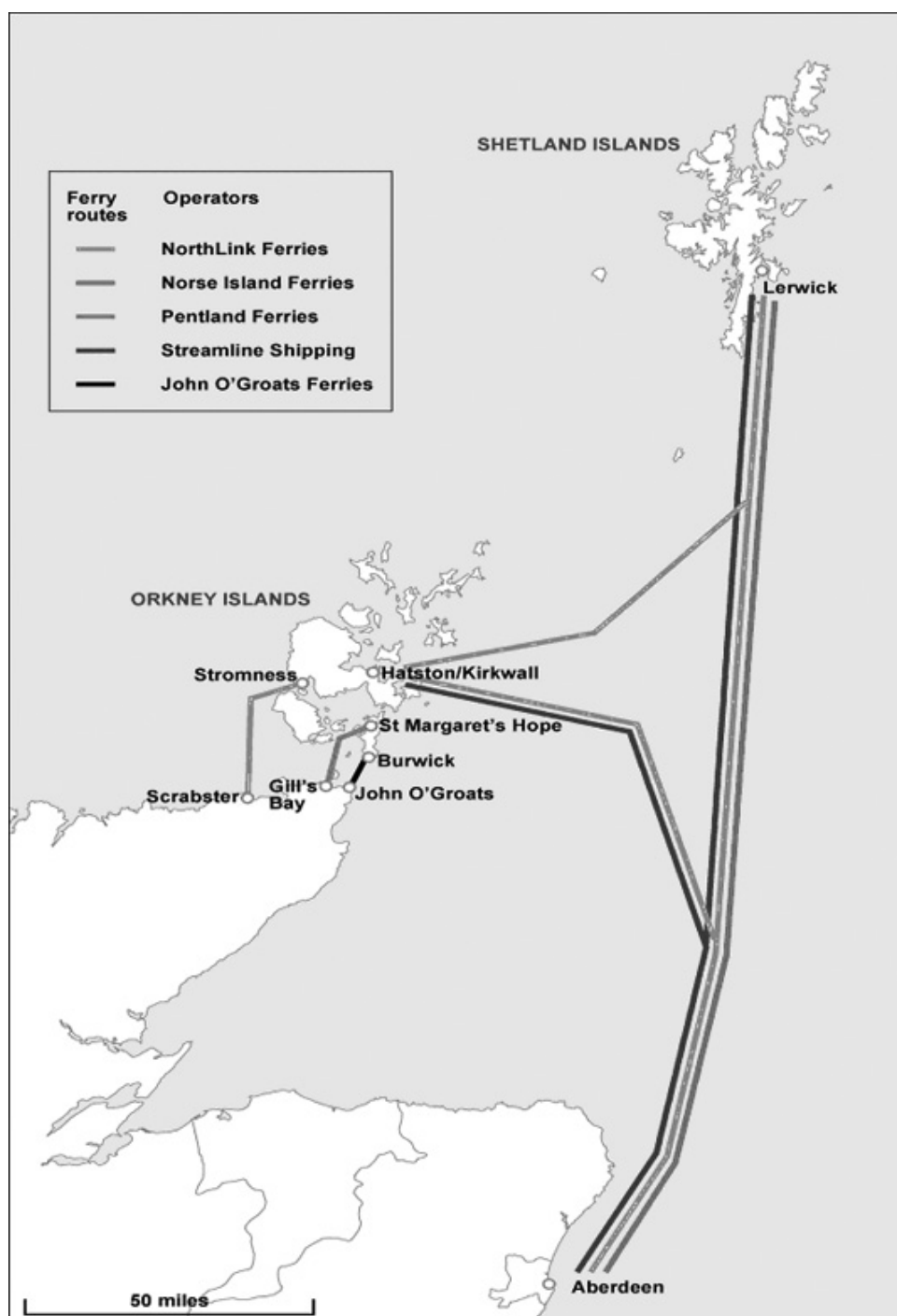
2.2. NORTHERN ISLANDS

2.2.1. MARITIME ROUTES

- (44) The existing ferry routes in the northern Scottish islands (Orkney and Shetland archipelagos) are set out in Map 3.

Map 3

Maritime routes in Northern Scotland



2.2.2. OPERATORS

2.2.2.1. **NorthLink**

- (45) NorthLink Orkney and Shetland Ferries Ltd (hereinafter 'NorthLink 1') was established in 2000 as a 50 %-50 % joint venture between the Royal Bank of Scotland, one of the leading banks in the United Kingdom, and CalMac.
- (46) Between 2002 and 2006 NorthLink 1 operated two routes under a public service contract: one triangular route between Aberdeen (Scottish mainland), Kirkwall (Orkney) and Lerwick (Shetland) and one shorter route between Scrabster (Scottish mainland) and Stromness (Orkney), across the Pentland Firth.
- (47) The total annual maritime passenger traffic in those two routes is around 300 000.
- (48) In 2006, a new company was established – NorthLink Ferries Ltd (hereinafter 'NorthLink 2') as a wholly-owned subsidiary of CalMac (itself fully-owned by the Scottish Government). NorthLink 2 took over the operation of the two northern islands routes and most of the assets and personnel of NorthLink 1 in 2006. It operates under a public service contract signed on 6 July 2006 and valid until 2012.
- (49) NorthLink 2 currently operates two combined passenger, car and freight vessels and two freight and livestock vessels.
- (50) NorthLink 1 still exists but it is basically a dormant company, with no regular activities and few assets.

2.2.2.2. **P&O Ferries**

- (51) Between 1997 and 2002, P&O Ferries operated the two routes later served by NorthLink 1 and 2 under a public service contract. P&O Ferries no longer operates on these routes.

2.2.2.3. **Pentland Ferries**

- (52) Since 2001, Pentland Ferries has been operating a daily service in the route between Gills Bay in the Scottish mainland and St. Margaret's Hope in Orkney. Pentland Ferries operates two passenger, vehicle and freight services and currently carries around 80 % of all livestock and dangerous goods cargoes between the Scottish mainland and the Orkney Islands.

2.2.2.4. **Streamline Shipping**

- (53) Since 1984 Streamline Shipping has been operating a bi-weekly container freight service between Aberdeen and Lerwick, using chartered freight lift-on lift-off vessels or its own container ship. In 1987 it also started container freight services from Aberdeen to Kirkwall in Orkney, using chartered freight load on/load off (hereinafter 'lo-lo') vessels.
- (54) In mid-2008, Streamline Shipping was awarded a freight contract for freight transport to the northern islands by the Scottish Executive.

2.2.2.5. **John O'Groats Ferries**

- (55) Since 1971 John O'Groats Ferries has been operating a tourist passenger ferry service from John O'Groats in the Scottish mainland to Burwick in Orkney. John O'Groats Ferries only operates its service from May until the end of September.

2.2.2.6. **Norse Islands Ferries**

- (56) Between September 2002 and June 2003, Norse Islands Ferries operated one and at times two freight-only vessels between the Scottish mainland and the Shetland Islands. Norse Islands Ferries no longer operates on this route.

2.2.3. PUBLIC SERVICE OBLIGATIONS

- (57) Two northern islands routes have been subject to public service obligations: the triangular route between Aberdeen (Scottish mainland), Kirkwall (Orkney) and Lerwick (Shetland) and the shorter route between Scrabster (Scottish mainland) and Stromness (Orkney).
- (58) Those routes were the subject of three public tenders leading to three public service contracts between the Scottish authorities and three operators: P&O Ferries from 1997 to 2002, NorthLink 1 from 2002 to 2006 and NorthLink 2 from 2006 to 2012. In the first two tenders, the public service obligations covered only passenger traffic (freight transport was not subsidised but was not prohibited either). However, the 2006 to 2012 contract also includes a public service obligation for freight transport with a fixed limit.

2.2.3.1. **The 1997 public service contract with P&O Ferries**

- (59) The Scottish authorities launched an open tender exercise in June 1995 for the Aberdeen-Kirkwall-Lerwick and Scrabster-Stromness routes. They decided not to allow CalMac to take part in the tender.

(60) The tender led the Scottish Executive to choose P&O Ferries. Pursuant to the public service contract, P&O Ferries was to be paid an annual grant, subject to 'claw back arrangements' aimed at capping possible benefits, should the company's profits exceed forecasts. P&O Ferries received GBP 55 million from the Scottish authorities over the period 1997 to 2002 ⁽¹⁶⁾ for the execution of the contract.

(61) Under the public service contract, the subsidy was limited to passengers, accompanied cars and associated vehicles, such as motorhomes and motorcycles.

2.2.3.2. *The 2000 public service contract with NorthLink 1*

(62) In 1998 the Scottish Executive launched a new tendering process for a public service contract on the Aberdeen-Kirkwall-Lerwick and Scrabster-Stromness routes for the 2002-07 period.

(63) While the service specifications of the public tender indicated that operators would be required to provide capacity to carry freight, this element of the service was expected to be operated on a commercial basis, that is to say without subsidy. It was left for bidders to determine the precise level of freight services to be made available, although the capacity should be sufficient to carry at least the levels provided by P&O Ferries at the time, including reasonable increases for estimated growth in demand.

(64) The public tender specified the route configuration and minimum number of sailings required but requested bidders to propose detailed timetables. It required the successful bidder's pricing plan to be agreed with the Scottish Executive and maximum tariffs to be published. It was expected that initial tariffs would not be set at a level significantly above prevailing rates.

(65) In November 1998, thirteen shipping operators expressed an interest in the public tender. Six ferry operators were short-listed and three ultimately submitted bids in June 1999: SERCO Denholm, P&O Ferries and NorthLink 1.

(66) The Scottish Executive ruled out the bid from SERCO Denholm because it was the highest bid and also because it considered unacceptable the bidder's request to be allowed to sell its vessels or transfer ongoing leases to the Scottish Executive at the end of the contract.

(67) In September 2000 the Scottish Executive chose NorthLink 1 as the preferred bidder. NorthLink 1's bid for basic subsidy of GBP 45,7 million for the 5-year contract was GBP 14 million cheaper than P&O's bid. NorthLink 1's estimated costs were higher than P&O Ferries' but it anticipated generating about GBP 8 million more passenger income and GBP 13 million more from freight surpluses because its traffic growth assumptions were higher. NorthLink 1 was also prepared to accept less profit from the contract than P&O Ferries.

(68) The contract between NorthLink 1 and the Scottish Executive was signed in December 2000. Following the contract award, NorthLink 1 ordered three new passenger/vehicle ferries and acquired a second-hand dedicated freight vessel.

(69) It had first been anticipated that the new operator would have the time to commission and build new vessels to be ready to start operations in April 2002. However NorthLink 1 was only in a position to start operations on 1 October 2002. Because of this delay, the Scottish Executive prolonged the public service contract with P&O Ferries for 6 months.

(70) NorthLink 1's cost and revenue projections underlying its bid proved to be too optimistic. P&O Ferries had been the only operator offering a roll on/roll off (hereinafter 'ro-ro') service for passengers, cars and freight between the Scottish mainland and the northern islands between 1997 and 2002. In its projections NorthLink 1 had also assumed that it would enjoy a monopoly on ro-ro traffic.

(71) However, that assumption did not materialise. In the spring of 2001 a new operator, Pentland Ferries, started providing services from the Scottish mainland to Orkney and progressively took a substantial share of the Orkney passenger, car and freight market.

(72) In July 2002 a consortium of three road hauliers ⁽¹⁷⁾ announced that they would be part of a new ferry company, Norse Island Ferries, in reaction to the freight fares announced by NorthLink 1 in 2001, which they considered too high compared to the fares previously offered by P&O Ferries. In early September 2002 Norse Island Ferries started to offer a daily ro-ro freight service between Shetland and the Scottish mainland and, for the early months of its operation, appeared to be carrying a large proportion of the freight market.

⁽¹⁶⁾ Source: Report of Audit Scotland of December 2005 on the NorthLink ferry services contract. The report is available at the following internet address: http://www.audit-scotland.gov.uk/docs/central/2005/nr_051222_northlink_ferry.pdf

⁽¹⁷⁾ These three road hauliers handled around 80 % of the freight transported between the Shetland Islands and the Scottish mainland, resorting to ferry services of P&O Ferries.

- (73) Following the announcement in 2001 of the new freight service by Pentland Ferries, NorthLink 1 requested discussions with the Scottish Executive about the impact of this new competition on its financial position. NorthLink 1 made available to the Scottish Executive their business model to allow it to examine the impact of the competition on the company's viability. Based on this model, NorthLink 1 was initially projecting a total return over the lifetime of the contract of GBP 14,9 million. The changed circumstances turned this figure into a projected loss of GBP 16,4 million. This raised serious concerns over the solvency of the contractor and its ability to execute the contract. According to the United Kingdom, the chief factor in this was the competition from Norse Island Ferries as this accounted for over GBP 25,5 million of the GBP 31,3 million negative turnaround in the company's books.
- (74) The competition on the Shetland freight market from Norse Islands Ferries came to an end in early June 2003, following the decision of the latter to cease trade. This offered the prospect of NorthLink 1 moving back on to a viable basis. The Scottish Executive thus decided to continue to fund NorthLink 1 in line with the terms of the public service contract, believing that the cessation of Norse Islands Ferries could be sufficient to allow the contract to run its full term.
- (75) However, in the summer of 2003, a few months after starting operations, NorthLink 1 informed the Scottish Executive that it could no longer realistically fulfil its contractual obligations over the remainder of the public service contract period, i.e. to the end of September 2007.
- (76) The Scottish Executive reviewed the company's financial position, with the assistance of independent accountants, and concluded that NorthLink 1 was near insolvency.
- (77) According to the Scottish Executive, if additional subsidies were not paid to NorthLink 1 there was a risk that, if the company had any formal insolvency proceedings filed against it (which could have been done by a number of creditors), the lifeline services would be interrupted. The long-term future of the public service obligations would depend on the willingness of the receiver appointed to manage the company. The receiver would not be bound by any contractual obligations of the company and would not, therefore, be bound to provide the subsidised service.
- (78) On 8 April 2004 the Scottish Executive announced, following contacts with the Commission services, its intention to retender the service and published a Contract Notice in the *Official Journal of the European Union* relating to this tender. In parallel to this new tender procedure, which will be described further below, the Scottish Executive took a number of actions to ensure the continuity of the lifeline services in the interim.
- 2.2.3.3. The 2004 Minute of Amendment with NorthLink 1**
- (79) On 29 September 2004, the Scottish Executive concluded with NorthLink 1 revised funding arrangements, through a Minute of Amendment (hereinafter 'MoA') to the public service contract. This MoA provided for a deficit funding system, ensuring that NorthLink 1 could continue the services until the handover of the contract and to the standard specified in its specifications. The MoA also provided that certain assets, leased or owned by NorthLink 1, could be made available on the occasion of the next public tender, on a discretionary basis and at estimated market value, to bidders who would wish to use them in delivering the services within the framework of the future contract. With a view to maintaining budgetary control over that period, the MoA involved measures controlling NorthLink 1's ability to go exceed the terms of an agreed budget without the approval of the Scottish Executive.
- (80) In addition, the MoA provided for limited 'incentive payments' of around GBP 1,5-2 million per year, assuming a range of demanding service performance, cost and revenue targets would be met or exceeded. A first element of the incentive payment would be paid provided a range of punctuality, reliability and other service performance targets were met in full. This element was designed to replace and enhance the system of performance penalties built into the original agreement. A second element would be paid on the delivery of cost savings/revenue gains in comparison to a benchmark budget which the Scottish Executive's independent accountants would have approved.
- (81) In August 2005, the Auditor General for Scotland asked Audit Scotland to examine the new public service contract awarded to NorthLink 1. Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000⁽¹⁸⁾ to provide services to the Auditor General. Their mission is to ensure that the Scottish Executive is held to account for the proper, efficient and effective use of public funds.
- (18) The text of this Act is available at the following internet address: http://www.opsi.gov.uk/legislation/scotland/acts2000/asp_20000001_en_1

- (82) According to the report published by Audit Scotland ⁽¹⁹⁾ in December 2005, NorthLink 1 received from the Scottish Executive GBP 71 million over the three first years of the public service contract, covering the period from October 2002 to end-September 2005, to be compared with compensation provided for under the contract limited to GBP 50,3 million. The report gives the following break-down for the GBP 71 million received:
- (a) GBP 33,6 million of basic compensation under the original contract;
 - (b) GBP 16,7 million of other payments allowed for under the terms of the original contract;
 - (c) GBP 18,2 million of additional funding to maintain the delivery of services; and
 - (d) GBP 2,5 million to pay off in one instalment some leases used by NorthLink 1.
- (83) On the basis of the information submitted by the UK authorities, the Scottish Executive made a further grant of GBP 21,6 million to NorthLink 1 between September 2005 and the handover of the contract to its successor on 6 July 2006.
- (84) The United Kingdom has provided financial information showing the net turnover of the public service activities (mostly passenger transport) and of the commercial activities (mostly freight transport) carried out by NorthLink 1 from the 2002/2003 financial exercise to the 2005/2006 financial exercise:

Table 3

Profit and loss account of public service and commercial activities of NorthLink 1 from 2002/2003 to 2005/2006

(GBP million)							
	Public service activities			Commercial activities			Total
	Revenues	Expenses	Profit/Loss	Revenues	Expenses	Profit/Loss	Profit/Loss
2002/2003	26,7	– 28,3	– 1,7	7,7	– 7,3	0,5	– 1,2
2003/2004	38,0	– 35,5	2,5	10,5	– 10,0	0,5	3,0
2004/2005	33,8	– 34,6	– 0,8	10,3	– 10,1	0,1	– 0,7
2005/2006 ⁽¹⁾	31,1	– 30,2	0,9	7,4	– 7,2	0,2	1,1

⁽¹⁾ In the 9-month period to 6 July 2006.

- (85) The amounts indicated in table 3 result from an analytical accounting exercise on the basis of the statutory accounts. Commercial revenues correspond to income from transporting freight and livestock ⁽²⁰⁾. Public service revenues comprise the Government funding and revenues from the sale of tickets. On the expenditure side, common costs such as harbour dues, terminal costs and administrative expenses, are split according to the relative weight of public service and commercial activities in those costs.
- differences were found between the amounts reported in table 3 above and the underlying books and records of NorthLink 1.
- 2.2.3.4. The 2006 public service contract with NorthLink 2**
- (87) In March 2004, the United Kingdom informed the Commission about the intention of the Scottish Executive to retender the public service contract as quickly as possible.
- (86) Agreed procedures have been carried out by the Company Auditor (KPMG LLP) on the methodology, accounting detail and statement content. No significant
- (88) On 8 April 2004, the Scottish Executive publicly announced its intention to retender the service and published a Contract Notice in the *Official Journal of the European Union* relating to the tendering of the service. On 27 May 2004, it published a draft service specification for the tender as part of a consultation exercise.

⁽¹⁹⁾ See footnote 16.

⁽²⁰⁾ Livestock transport and freight transport fell outside the scope of the public service contract.

(89) Unlike the 2000 tender, the new invitation to tender ⁽²¹⁾ introduced public service obligations on freight services. The winning bidder would have to provide a comprehensive ro-ro freight service, encompassing livestock and dangerous goods and an additional freight sailing required during the week on the Kirkwall to Aberdeen service. The 2005 tariff levels were the base for 2006, allowing for indexation using the Consumer Price Index. The tariff levels for general freight had to be reduced on the Aberdeen/Kirkwall/Lerwick routes in each direction, around 19 % on the Kirkwall to Aberdeen route and 25 % on the Shetland Islands route.

(90) NorthLink 1 owned assets which were relevant for the operation of the contract, such as information technology hardware, vessel spare parts and equipment, port equipment, office equipment, various stocks and livestock trailers. It also had ongoing lease contracts for a freight vessel, towing vehicles and a ticketing system. These assets and contractual agreements were made available to all bidders on the basis of estimated market value.

(91) On 19 July 2005, the Scottish Executive invited three short-listed companies to bid. Subsequently, two bids were submitted on 30 November 2005 and the third company withdrew from the process in October 2005. On 9 March 2006 the Scottish Executive announced the selection of the preferred bidder – CalMac.

(92) A new company was established, NorthLink 2, as a wholly-owned subsidiary of CalMac (itself fully-owned by the Scottish authorities) to run the public service contract awarded to CalMac, which was signed on 6 July 2006. The public service contract covered the period from 2006 to 2012. NorthLink 2 took over the

operation of the two northern islands routes and most of the assets and personnel of NorthLink 1.

(93) According to the United Kingdom, all of the assets of NorthLink 1 that NorthLink 2 wished were bought by the latter at actual or estimated market prices.

(94) NorthLink 2 has received the following payments from the Scottish authorities in relation to the 2006 public service contract:

Table 4

Public money granted to NorthLink 2 since 2006

(GBP million)			
	Deficit grants	Capital grants	Total
2006/2007 ⁽¹⁾	21,8	1,3	23,1
2007/2008 ⁽²⁾	28,0	2,0	30,0

⁽¹⁾ Figures relate to the period from 6 July 2006 (the date when the public service contract entered into force) to 31 March 2007.

⁽²⁾ Figures relate to the period from 1 April 2007 to 31 March 2008.

(95) NorthLink 2 has not carried out any activities outside the scope of the 2006 public service contract (which includes carrying of livestock and freight). Therefore, all of its activities are considered as public service obligations. The United Kingdom has provided financial information showing the net turnover of the activities carried out by NorthLink 2 since the 2006/2007 contract year. For indicative purposes, they have provided a notional breakdown of these results between freight and passengers (and accompanied cars):

Table 5

Profit and loss account of public service activities of NorthLink 2 in 2006/2007 and 2007/2008 ⁽²²⁾

(GBP million)							
	Passengers and accompanied cars			Freight			Total
	Revenues	Expenses	Profit/Loss	Revenues	Expenses	Profit/Loss	Profit/Loss
2006/2007	38,3	– 37,5	0,8	12,1	– 11,8	0,3	1,1
2007/2008	39,7	– 38,6	1,0	10,9	– 10,6	0,3	1,3

(96) The amounts set out in table 5 result from an analytical accounting exercise on the basis of the statutory accounts.

(97) Agreed procedures have been carried out by the Company Auditor (KPMG LLP) on the methodology, accounting detail and statement content. No significant differences were found between the amounts reported in table 5 above and the underlying books and records of NorthLink 2.

⁽²¹⁾ A summary of the 2006 invitation to tender is available at the following address on the website of the Scottish Executive: <http://www.scotland.gov.uk/Resource/Doc/55971/0015831.pdf>

⁽²²⁾ Figures are for Contract Years ending on 30 June. Statutory Accounting Years end on 31 March.

2.2.4. TRANSPORT FARES

- (98) Table 6 shows the fares charged for freight transport since 1 January 2000 by the public service contract operator (ro-ro freight service) and by Streamline Shipping (lo-lo freight service).

Table 6

Comparison of freight fares per linear metre between public service contract operator and Streamline Shipping⁽²³⁾

Year	Public service contract operator		Streamline Shipping ⁽¹⁾	
	Shetland	Orkney	Shetland	Orkney
2000 (P&O Ferries rates)	43,70	37,90	37,05	31,62
2002 (indicative rates by NorthLink 1)	44,00	36,00		
2002/2003 (NorthLink 1 rates)	36,00	25,50	33,69	29,40
2004 (NorthLink 1 rates)	38,50	27,50	34,87	28,86
2005 (NorthLink 1 rates)	39,45	28,20	33,24	30,29
2006 (NorthLink 1 rates)	40,60	29,00	40,43	32,07
July 2006 (NorthLink 2 rates)	30,60	23,50	40,43	32,07

(1) Since rates for lo-lo operations are not usually quoted per linear metre, Streamline Shipping has calculated its rates on a per linear metre basis in order to make the comparison.

- (99) Streamline Shipping contends, on the basis of the published data, that NorthLink 1 and NorthLink 2 have depressed freight prices to a level which is not sustainable for Streamline Shipping and this has been possible only because of the subsidies received by the public service operator for passenger traffic.

that these rates would be fixed for a period of 5 years. NorthLink 1 stated that it could not 'sustain a situation when we [NorthLink 1] carry trailers for free or for very small amounts'. At the same time, NorthLink 1 emphasised that its freight business was not subsidised.

- (100) The United Kingdom points out the comparison illustrated in Table 6 is potentially misleading since Streamline Shipping does not charge per linear metre⁽²⁴⁾. They claim that lo-lo and ro-ro services represent different segments of the freight market to the northern islands, even though some overlaps can occur in using the two services. The lo-lo operation tends to be less time-sensitive with only two services per week and cargo is typically of lower value. Thus, the United Kingdom claims that any comparison of the two services is artificial and that it is difficult to draw conclusions from any such comparison.

- (102) According to Streamline Shipping, NorthLink 1 responded to the competition from Streamline Shipping and Norse Island Ferries by introducing in 2002, at the very beginning of its contract, significant reductions (to GBP 36 and GBP 25,50 per linear metre for trailers to Shetland and Orkney respectively) on the charges previously indicated by NorthLink 1 as being commercially sustainable. Streamline Shipping and Norse Island Ferries suspect that NorthLink 1 was providing its freight services at below cost.

- (101) NorthLink 1 indicated in December 2001 – prior to executing the public service contract – that it would charge GBP 44 and GBP 36 per linear metre for trailers to Shetland and Orkney respectively. These rates were justified by the fact that NorthLink 1 needed to charge a rate that was both commercially sustainable and acceptable to the market. It was also stated

- (103) NorthLink 1 introduced specific reduced rates in December 2003:

- (a) A special rate for empty trailers;
- (b) A special flat rate of GBP 200 for non-time-sensitive goods travelling between Aberdeen and Kirkwall (the so-called 'Sunday Special'); and
- (c) A commercial traffic rebate scheme providing for discounts of up to 10 % determined according to the level of eligible lane metres shipped per month.

⁽²³⁾ Source: Streamline Shipping.

⁽²⁴⁾ The lo-lo service typically involves grouping and consolidating individual loads including loose freight or pallets which are often reloaded into a container and loaded on to a cargo vessel.

- (104) Since NorthLink 2 started in July 2006 to execute the third public service contract, the commercial pressure exerted on Streamline Shipping has allegedly increased further. According to Streamline Shipping, the then Minister for Transport, when awarding to NorthLink 2 the new public service contract, announced that freight rates from Aberdeen to Shetland would be reduced by 25 % and to Orkney by 19 %. This was only possible, according to Streamline Shipping, thanks to the increased annual subsidy to NorthLink 2.
- (105) According to Streamline Shipping, in July 2006 the standard rates charged by NorthLink 2 were GBP 30,60 per linear metre for Shetland and GBP 23,50 per linear metre for Orkney. These rates are to be compared with GBP 40,43 per linear metre for Shetland and GBP 32,07 per linear metre for Orkney charged by Streamline Shipping. In addition, the empty trailer and 'Sunday Special' concessions have allegedly remained in place, with reductions on the rates offered by NorthLink 2 of up to 73 %.
- (106) Streamline Shipping argues that, whilst it has sought in the past to compete by reducing rates, the scale of the reductions afforded to customers by NorthLink 2 has rendered this strategy no longer possible. Streamline Shipping estimates that to cover its costs it must charge rates which are equivalent to GBP 36,67 per linear metre. Such a rate is higher than the rates currently offered by NorthLink 2.
- (107) Pentland Ferries argues that NorthLink 2 has been practicing a discount scheme for Orkney residents called 'friends and family' that is having a very detrimental effect on the competing service provided by Pentland Ferries, especially since the start of the operation of Pentland Ferries' new catamaran Pentalina in March 2009. Namely, it is argued that in 2008/2009 NorthLink has been extending this discount to a very large number of 'friends and family', thereby effectively decreasing passenger travel prices in a generalised way and damaging the competing service offered by Pentland Ferries.
- (108) The discount scheme consists in islanders nominating up to 6 Family and Friends households, which live outside Orkney and Shetland, to be eligible to receive a 30 % discount on their NorthLink travel ⁽²⁵⁾.
- (109) The UK authorities explained that this discount scheme, which is available only in the Low and Mid seasons, only benefited 4 952 passengers in 2008. Since NorthLink 2 carried 295 913 passengers in 2008, the discount scheme accounts for only 1,6 % of NorthLink 2's carryings. Total revenue from this scheme (for all eligible passengers and cars) in 2008 amounted to around GBP 95 000 which compares with NorthLink 2's total fare box revenues for 2008 of around GBP 20 million, that is to say less than 0,5 % of total revenues. The UK authorities argue that such a small-scale discount scheme is unlikely to have any significant effect on the commercial interests of Pentland Ferries.
- (110) The published passenger tariffs of NorthLink 2 (Scrabster-Stromness) and Pentland Ferries (Gill's Bay – St Margaret's Hope) are currently the following ⁽²⁶⁾:

Table 7

Comparison of published passenger fares between public service contract operator and Pentland Ferries

(GBP)

	NorthLink 2			Pentland Ferries	
	Low ⁽¹⁾	Mid ⁽²⁾	Peak ⁽³⁾	To 31.3.2009	1.4.2009 – 31.10.2009
PASSENGERS					
Adult single	13,80	15,00	16,10	10,00	13,00
Child single (5-15 yrs)	6,90	7,50	8,10	5,00	6,00
Infant (0-4 years) ⁽⁴⁾	FREE				
VEHICLES					
Car and motorhome (< 6 m)	43,60	44,80	48,20	25,00	30,00
Motorcycle	13,20	15,00	16,70	10,00	11,00

⁽¹⁾ Low season: January, February, March, November, December (excluding 19 December – 8 January).⁽²⁾ Mid season: April, May, June, September, October, and 19 December – 8 January.⁽³⁾ Peak season: July, August.⁽⁴⁾ Pentland Ferries does not charge for children up to 5 years old.⁽²⁵⁾ Source: NorthLink's web site (www.northlinkferries.co.uk).⁽²⁶⁾ Source: respective web sites (www.northlinkferries.co.uk and www.pentlandferries.co.uk).

- (111) It was also argued by an interested party that NorthLink 2 is offering Bed & Breakfast accommodation in Orkney (when the ship is static overnight) as a commercial activity at rates which are below cost and that this is affecting hotel-based Bed & Breakfast providers.

2.3. GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

2.3.1. WESTERN ISLANDS

2.3.1.1. *Existence of State aid*

- (112) With regard to the State aid payments made to CalMac until the signature of the 2007 contract, in the decision to start the formal investigation procedure, the Commission expressed doubts about whether these payments met the criteria laid down in the Altmark case⁽²⁷⁾ and consequently fell outside the concept of State aid in accordance with Article 87(1) of the Treaty.

- (113) Namely, the Commission doubted whether: the public service obligations imposed on CalMac had been clearly defined; the parameters on the basis of which the compensation had been calculated had been established before the imposition of the public service obligations in an objective and transparent manner; there had been an overcompensation of the costs borne by CalMac with the performance of the public service obligations; the level of compensation needed had been determined on the basis of an analysis of the costs which a typical and well run undertaking would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit.

- (114) The Commission came to the preliminary conclusion that the relevant payments to CalMac until the signature of the 2007 contract could involve an advantage and might thus constitute State aid within the meaning of Article 87(1) of the EC Treaty.

- (115) As regards the 2007 public service contract with CalMac, the Commission did not have sufficient information to draw preliminary conclusions about the existence of State aid and requested the UK authorities submit the required information.

- (116) The Commission noted that some interested parties were of the view that the bundling of all routes, with the exception of the route between Gourock and Dunoon,

unduly and significantly restrained competition during the tender since only CalMac was allegedly able to offer a bid covering the entire bundle. Also, the Commission raised the question whether the tender condition that the successful bidder had to charter the CMAL vessels might have constituted an advantage to CalMac.

- (117) If that would have been the case, the Commission would consider that the contract has not been awarded through a truly open and non-discriminatory public procurement procedure. This might have led to a situation where the Scottish authorities paid a higher compensation for the relevant public service requirements that would otherwise have been the case and therefore to the existence of State aid within the meaning of Article 87(1) of the Treaty.

2.3.1.2. *Compatibility with the common market*

- (118) In the opening decision the Commission considered that Article 86(2) of the Treaty seemed to be the appropriate legal basis to assess the compatibility of the measure with the common market⁽²⁸⁾.

- (119) The Commission expressed doubts about the fulfilment of the conditions of its Decision on the application of Article 86(2) of the Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (hereinafter 'SGEI Decision')⁽²⁹⁾.

- (120) In order to be compatible pursuant to Article 86(2) of the Treaty, the subsidised services must correspond to genuine and legitimate services of general economic interest (hereinafter 'SGEI'), must be adequately entrusted to the beneficiary and the compensation must not cause disproportionate effects on competition and trade.

- (121) In the opening decision, the Commission took the preliminary position that the services entrusted to CalMac were legitimate SGEI but, for lack of evidence, was not in a position to assess whether the act of entrustment was adequate and whether the aid granted to CalMac was proportional to its objective and therefore to assess whether the possible State aid was compatible with the common market.

⁽²⁸⁾ See footnote 1.

⁽²⁹⁾ Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (OJ L 312, 29.11.2005, p. 67).

⁽²⁷⁾ Judgment of the Court of Justice of the European Communities of 24 July 2003 in case C-280/00, *Altmark Trans & Regierungspräsidium Magdeburg* [2003] ECR I-7747 (OJ C 226, 20.9.2003, p. 1).

2.3.2. NORTHERN ISLANDS

2.3.2.1. *Existence of State aid*

- (122) The Commission took the preliminary view that the financing of NorthLink 1 under the MoA was unlikely to meet the fourth Altmark criterion, which requires that the level of compensation is determined on the basis of an analysis of the costs which a typical and well run undertaking would have incurred in discharging the public service obligations. Thus, the payments in question were likely to constitute State aid pursuant to Article 87(1) of the Treaty.
- (123) With regard to NorthLink 2, the Commission sought clarifications on the transfer of assets from NorthLink 1 and on the compliance of the 2006 contract with the four Altmark conditions. The presence of State aid was therefore not excluded.

2.3.2.2. *Compatibility with the common market*

- (124) In its decision to start the formal investigation procedure the Commission could not identify a compatibility basis for the possible State aid to NorthLink 2 through a potential transfer of assets from NorthLink 1 below market price.
- (125) With regard to the possible State aid granted to NorthLink 1 under the 2000 contract and the MoA and to NorthLink 2 under the 2006 contract, the services delivered by these companies could be considered as legitimate SGEI and the acts of entrustment could be considered as appropriate. On the contrary, for lack of sufficient evidence it is doubtful whether the possible State aid granted to NorthLink 1 and 2 was proportional to its declared objective.

3. COMMENTS FROM INTERESTED PARTIES

- (126) During the time-frame provided for by Article 6(1) of the Procedural Regulation, the Commission received comments from several interested parties. In accordance with Article 6(2) of the Procedural Regulation, the UK authorities were given the opportunity to respond to the comments received from interested parties within that time-frame. The following interested parties submitted their views: the European Transport Workers' Federation, Mr James Knight of TSL contractors Limited, Western Ferries, Mr John Rose, Streamline Shipping, Professor Dr. Alfred J. Baird of Napier University, Pedersen Consulting, Mr James Knight and Mr Andy Knight (on behalf of Isle of Mull Ferry Company Limited), McGill's Bus Service Limited and two other parties which requested that their identity and the content of their submission be kept confidential.
- (127) Streamline Shipping's comments are similar to those made in its complaint of July 2004. They consider that the financial crisis of NorthLink 1 was a direct result of

that undertaking's strategy to damage competition, initially from Norse Island Ferries and subsequently from Streamline Shipping, by severely reducing the freight rates to unprecedented levels. It was this strategy that led the Government to inject finance beyond what was needed for the fulfilment of the public service obligations. They quote the Auditor General's report of December 2005, which stated that 'the level of freight charges and the resultant competition from Norse Island Ferries was one of the key factors which contributed to NorthLink 1's financial problems' and that 'while chartering the extra (freight) vessel was intended to ensure there was adequate capacity to meet demand, it created a situation whereby freight capacity actually exceeded demand. The additional costs of running another vessel exceeded the extra income generated and added to the cash flow problems'.

- (128) With regard to NorthLink 2, Streamline Shipping argues that its vessels are under-utilised. The announced reduction in market rates by 25 % to Shetland and 19 % to Orkney for NorthLink 2 when compared to the rates charged by NorthLink 1 has badly damaged Streamline Shipping, it is argued.
- (129) Western Ferries repeated its concerns about the subsidies paid to CalMac for the operation of the Gourock-Dunoon route. Western Ferries considers that this route is commercially viable, as demonstrated by its own profitable operation. It also considers that the Altmark conditions are not fulfilled since the level of the subsidy is more than that which would be needed in respect of a passenger-only service using a passenger-only vessel (estimated surplus of GBP 1,3 million). It is also argued that the aid is being used to subsidise the vehicle service, for example by keeping vehicle transport prices unchanged in the face of higher fuel costs (CalMac increased prices in 2009 by only 3,8 %, i.e. 1 % below inflation). Moreover, unlike the NorthLink and CalMac networks, this route has not been tendered out and is therefore not in line with EU requirements. Furthermore, Western Ferries considers that the recent tender for CalMac's network was too prescriptive and that the bundling of all routes is unwarranted. In such conditions, only CalMac was able to bid.
- (130) With regard to CalMac's financial transparency, it is claimed that the reported cost of the Gourock-Dunoon route (GBP 4,2 million in year to March 2008) underestimates the real full cost of the service because the pension liability relating to the respective crew is not reflected, there is no transparency in inter-company charges for shared head-office functions and the daily lease costs for the service vessel are significantly understated. There is no evidence that the Scottish Government has been actively monitoring possible cross-subsidisation of the vehicle business.

- (131) Western Ferries considers that, unlike in the situation of NorthLink, there is already sufficient market provision for passengers, cars and freight. For the future, there is no reason to subsidise vehicles due to the existing service of Western Ferries.
- (132) The European Transport Workers' Federation expressed disappointment that there is a need to review again the lifeline services provided by CalMac and NorthLink. They stress the need for a stable public service, which is legitimately defined in accordance with Council Regulation (EEC) No 3577/92 of 7 December 1992 applying the principle of freedom to provide services to maritime transport within Member States ⁽³⁰⁾ (hereinafter 'Maritime Cabotage Regulation').
- (133) One interested party expressed concerns about the dependency on a State provider whose monopolistic position is enforced through the channelling of State aid. This party considers that the tendering process for the routes operated by CalMac was narrowly defined and cannot be considered as an open tender. The interested party calls for unbundling of the routes subject to tender.
- (134) Mr James Knight considers that CalMac is not providing good value for money and that efficient private providers should take over the services currently provided by CalMac. He provides possible alternative plans to reduce the subsidies needed to operate the routes and to increase the incentives for innovation and cost efficiency.
- (135) Another interested party considers that the frequency restriction imposed on CalMac by the UK authorities on the Gourock-Dunoon route in fact constitutes State aid to Western Ferries, seriously distorts competition and reinforces the dominating position of Western Ferries. On the other hand, it considered that the State aid granted to CalMac is in exchange for a legitimate public service mission.
- (136) Mr John Rose considers that the tendering for the NorthLink 1 and NorthLink 2 contracts did not comply with EU rules. He also contends that the Gourock-Dunoon route cannot be considered as a lifeline service since a road alternative already exists and a private ferry company already provides a better service without subsidies.
- (137) Professor Alfred Baird submitted studies indicating that the efficiency of NorthLink's operations could be improved through improved fleet composition, that the increasing role of the State in Scottish ferry markets goes against EU policy and trends and that, in general, it is neither necessary nor desirable for the State to operate maritime transport services.
- (138) McGill's Bus Service considers that there is no need for the subsidised foot passenger service between Gourock and Dunoon, since they are already providing the same service on a commercial basis.
- (139) Pedersen Consulting argues that the tender process for the western islands was so complex and expensive to comply with, that only CalMac was able to tackle the process. As regards the Gourock-Dunoon route, Pedersen Consulting considers that there is no sense in retaining a subsidised vehicle transport service since Western Ferries already profitably carries almost 90 % of all vehicular traffic. However, a direct passenger connection with the Gourock rail head may make sense as a public transport operation. With regard to NorthLink, it is claimed that the tendering process was completely inadequate and resulted in an inefficient service, while Pentland Ferries already provides an unsubsidised and profitable service. The Stromness-Scrabster route could easily be made virtually obsolete, thereby saving taxpayers' money.

4. COMMENTS FROM THE UNITED KINGDOM ON THE OPENING DECISION AND ON THE COMMENTS FROM INTERESTED PARTIES

- (140) In its decision to open the formal investigation procedure the Commission expressed doubts as to whether the condition that the successful bidder in the public tender leading to the 2007 public service contract between the UK authorities and CalMac had to charter the CMAL vessels might have constituted an advantage to CalMac.
- (141) The UK authorities believe that there was no advantage in this provision for CalMac or CMAL. On the contrary, they consider that the ready availability of a fully compliant fleet capable of fulfilling the route requirements at commencement of the contract was an advantage to other bidders, lowered the barriers to potential bidders coming forward and created a level playing field in the tendering process.
- (142) The UK authorities referred to the Commission Communication on the interpretation of the Maritime Cabotage Regulation ⁽³¹⁾ (Section 5.3.2.1) which states that 'where Member States' authorities themselves own vessels or have them otherwise at their disposal, these may be placed at the disposal of all potential service operators under the same non-discriminatory terms'. The UK authorities consider that it would be almost impossible for a single operator to have a new fleet of compliant vessels to service all the routes and maintain the links to remote island communities in time for the beginning of the contract period.

⁽³⁰⁾ OJ L 364, 12.12.1992, p. 7.

⁽³¹⁾ Communication on the interpretation of Council Regulation (EEC) No 3577/92 applying the principle of freedom to provide services to maritime transport within Member States COM(2003) 595 final (not published in the Official Journal).

- (143) In the decision to open the formal investigation procedure, the Commission also questioned whether the bundling of all western islands routes in the 2006 public tender, with the exception of Gourock-Dunoon, would have unduly and significantly restrained competition during the tender as argued by some interested parties.
- (144) The UK authorities consider that tendering these routes as a single bundle was justified for a number of reasons: it maximised value for money for the Scottish Executive; it facilitated the provision of relief vessels in the event of a failure across the network; it avoided cherry picking of the more profitable routes; it facilitated management, enhanced fleet safety and maintenance; and avoided the additional administrative burden and cost of conducting multiple tenders.
- (145) According to the Commission Communication on the interpretation of the Maritime Cabotage Regulation (Section 5.5.3), 'Member States often wish to group public service routes to and from different islands into a single bundle in order to generate economies of scale and attract operators. Bundles as such are not contrary to Community law provided that bundling does not lead to discrimination. The most appropriate size of bundles should be decided by taking account of the best synergy to be made in meeting essential transport needs.'
- (146) In the decision to open the formal investigation procedure, the Commission also raised the question whether the transfer of certain assets ⁽³²⁾ in the amount of GBP 1,55 million from NorthLink 1 to NorthLink 2 had been carried out below market price, thereby possibly constituting State aid to NorthLink 2.
- (147) The UK authorities argued that the possibility to buy assets from NorthLink 1 was already foreseen in the public tender document and that therefore all bidders had equal access to these assets on the same conditions. During the tender process information was passed on to the two selected bidders about the prices of the assets up for sale. There was no obligation to buy the assets, though, as bidders might prefer to bring in their own solutions.
- (148) All bidders were allowed to inspect the vessels and the equipment and other assets. The value of the more significant assets (vessel, tug masters and NorthLink brand in the amount of GBP 1,3 million) was established by independent valuations. The remaining assets, in the amount of GBP 0,25 million were valued on the basis of market estimates.
- (149) With regard to the possible application of the SGEI Decision ⁽³³⁾, the UK authorities considered that most of the routes on the Clyde and Hebrides and on the NorthLink's network appear to be covered by the SGEI Decision. Only four of the routes served by CalMac and NorthLink do not fulfil the threshold criteria and these should be assessed directly pursuant to Article 86(2) of the EC Treaty.
- (150) The UK authorities considered that the public service contracts with CalMac and NorthLink constitute appropriate entrustment acts, by specifying in detail the nature and duration of the public service obligations, the undertakings and the territories concerned, the nature of any exclusive or special rights assigned to the undertakings, the parameters for calculating, controlling and reviewing the compensation and the arrangements for avoiding and repaying any overcompensation.
- (151) Moreover, CalMac and NorthLink are obliged to keep separate accounts for SGEI and non-SGEI activities, only the costs related to the SGEI activities can be subject to compensation (all variable costs incurred in providing the SGEI, a proportionate contribution of fixed costs common to SGEI and non-SGEI activities and a reasonable profit) and there are appropriate reporting and monitoring procedures in place.
- (152) With regard to the Gourock-Dunoon route, the UK authorities recognise that it may be questionable whether the service provided by CalMac constitutes a legitimate SGEI, since a private sector operator operates on an adjacent route without subsidy. However, they consider that the Western Ferries service is seen by many local people as complementary and useful but not as an effective substitute for the town centre to town centre CalMac service.
- (153) The UK authorities informed the Commission that, after the unsuccessful tender procedure carried out in 2006 for the Gourock-Dunoon route, they intend to launch a new open, transparent and non-discriminatory public tender for a public service contract for this route with the following characteristics:
- (a) the public service contract will cover a town centre to town centre ferry service by means of a 6-year public service contract;
 - (b) the tender will allow for a subsidy to operate this route (unlike the preceding tender);

⁽³²⁾ A vessel, tug masters, vessel engineering spares, port equipment, IT hardware, NorthLink brand, etc.

⁽³³⁾ See footnote 29.

(c) the current timetable restrictions will be removed;

(d) the subsidy will cover only passenger traffic;

(e) the winning bidder will be allowed to provide an unrestricted commercial vehicle transport service, subject to appropriate accountancy measures and audit monitoring to prevent cross subsidisation from the passenger service to the commercial vehicle service;

(f) the winning bidder will be free to bring in its own vessel solutions, replacing the old vessels currently operating on the route.

(154) The UK authorities intend to procure the replacement vessels through CMAL, which will then lease them to the operator awarded the public service contract. The UK authorities consider that this SGEI is justified for several reasons dealing with the frequency, convenience of service, overall journey time, integration with other means of transport and service reliability, among others.

5. ASSESSMENT OF THE MEASURE

5.1. EXISTENCE OF STATE AID

5.1.1. CRITERIA PURSUANT TO ARTICLE 87(1) OF THE TREATY

(155) Under Article 87(1) of the Treaty ‘... any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.’

(156) The criteria laid down in Article 87(1) of the Treaty are cumulative. Therefore, in order to determine whether the above-described payments to CalMac, NorthLink 1 and NorthLink 2 constitute State aid within the meaning of Article 87(1) of the Treaty, it must be established whether the financial support:

- involves a loss of State resources imputable to the State;
- provides a selective advantage to certain undertakings or the production of certain goods;
- distorts or threatens to distort competition; and
- affects trade between Member States.

(157) The various payments described above have been granted through State resources and are imputable to the

Member State concerned. Thus, the first criterion pursuant to Article 87(1) of the Treaty is met.

(158) The relevant payments, in the form of deficit grants and capital grants/loans are only made to certain specific undertakings. They are therefore selective.

(159) The regular financing of CalMac and NorthLink 1 and NorthLink 2 reduces the operating costs that these undertakings would normally have to bear and provides them with an economic benefit compared to other undertakings which finance their activities based on commercial revenues only. Nevertheless, in order to establish that there is an advantage capable of constituting State aid in the sense of Article 87(1) of the Treaty, the Commission must assess whether the ‘Altmark conditions’ are fulfilled ⁽³⁴⁾.

(160) The market for maritime cabotage routes has been fully liberalised since the entry into force of the Maritime Cabotage Regulation, i.e. since 1 January 1993. If an advantage had been granted to any of those undertakings taking into account the Altmark criteria, this advantage would be liable to distort competition and affect trade between Member States. As such, the third and fourth criteria of Article 87(1) of the Treaty would also be fulfilled.

(161) The Commission also confirms its preliminary assessment that the payments made to CalMac and NorthLink 1 and NorthLink 2 are not consistent with the behaviour that a private investor would have under normal market conditions. Therefore, those payments cannot be considered as exempt from State aid on the basis of the market economy investor principle.

(162) The sale of assets that occurred during the transition from the NorthLink 1 to the NorthLink 2 contracts did not contain State aid elements. All assets owned by NorthLink 1 which were relevant for the operation of the ferry services were made available to all bidders during the 2004-2005 public tender (see recital 88 above). The sale, which totalled around GBP 1,5 million for all assets, was carried out on the basis of the actual market price or the estimated market price, depending on the assets. Since these assets were available at the same price to all bidders and since these prices corresponded to the market price of the goods, their sale did not involve the use of State resources and did not confer a selective economic advantage to any undertaking. Thus, the existence of State aid elements in the asset sale is excluded.

⁽³⁴⁾ See footnote 27.

(163) In the decision to open the formal investigation procedure, the Commission questioned whether the rates charged for certain loans advanced to CalMac were consistent with the market economy investor principle and therefore whether they contained State aid.

(164) This would have been important to establish whether CalMac had been overcompensated for discharging its public service obligations, taking into account all sources of public funding. However, since in the case of CalMac the aid scheme is an existing aid and since its compatibility must only be assessed for the future (see Section 5.2 below), there is no need for the Commission to further assess the State aid character of these loans as they only relate to the past.

5.1.2. ALTMARK CRITERIA

(165) As mentioned in recital 112 above, in order to establish that there is an advantage capable of constituting State aid in the sense of Article 87(1) of the Treaty, the Commission must assess whether the Altmark conditions are fulfilled.

(166) According to the Altmark case-law, compensation for public service obligations or contracts does not favour the recipient(s) - and thus does not fall within the scope of the prohibition laid down in Article 87(1) of the Treaty - when the following four conditions are cumulatively met:

- the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined (hereinafter 'Altmark 1'),
- the parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner (hereinafter 'Altmark 2'),
- the compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations (hereinafter 'Altmark 3'), and
- where the undertaking which is to discharge public service obligations is not chosen in a public procurement procedure, the level of compensation needed has been determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately equipped, would have incurred in discharging those obligations, taking

into account the relevant receipts and a reasonable profit for discharging the obligations (hereinafter 'Altmark 4').

5.1.2.1. *CalMac*

(167) In the case of CalMac, there are two distinct stages as indicated in the decision to open the formal investigation procedure: a first stage prior to the 2007 contract when the public service obligations were directly entrusted to CalMac without a prior public tender via 'undertakings' and when all the conditions of the provision of public service were specified in annual letters sent to CalMac by the Scottish authorities; and a second stage after the 2007 contract, which was awarded following a public tender procedure specifying in detail the public service obligations. The situation of the Gourock-Dunoon route must be distinguished since this route was excluded from the 2007 contract and the conditions of the public service obligations continue to be specified in annual letters sent to CalMac by the Scottish authorities.

(a) **Before the 2007 contract**

(168) As indicated in the decision to open the formal investigation procedure, there is little doubt that before the 2007 contract the compensation for the public service obligations imposed on CalMac did not fulfil all the Altmark criteria. The public service obligations were not clearly defined in a legal Act. Moreover, the specifications of the public service obligations, such as the ports to be served, regularity, continuity and frequency were not clearly established in a formal act. The parameters for establishing the compensation were not established ex ante in a transparent manner and the level of compensation was not calculated on the basis of an analysis of the costs of a typical undertaking. The preliminary assessment of the decision to open the formal investigation procedure is therefore confirmed.

(169) Since the compensation for the operation of the Gourock-Dunoon route is still done on that basis, the assessment above also applies to this route.

(b) **After the 2007 contract**

Altmark 1 – clearly defined public service obligations

(170) In this particular sector there is a Regulation specifying what elements should be part of an adequate definition of public service obligations. The fulfilment of the Altmark 1 criterion should therefore be assessed with regard to Article 4 of the Maritime Cabotage Regulation, which sets out the specifications that should be part of the definition of the public service obligations, namely: ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessels.

(171) The 2007 contract clearly meets this condition by defining in detail all these parameters. Precise figures for manning of the vessels are not included in the tender document, but the requirements, for example, in terms of quality of service and protection of employment regulations leave little margin for significant discrepancies in the manning of the vessels.

(172) The public service contract also has a reasonable duration – 6 years – in compliance with the Community guidelines on State aid to maritime transport ⁽³⁵⁾ (hereinafter ‘Maritime Guidelines’).

Altmark 2 – ex ante, objective and transparent establishment of parameters for compensation

(173) In the context of the Altmark assessment, the second condition requires that the parameters for the compensation are clearly established in advance in an objective manner, taking into account all the variables (e.g. fuel costs, investments in new vessels, etc.).

(174) On the one hand, before the public service obligations started being discharged, the parameters for compensation were rather clear. They were equal to the costs foreseen by the bidders, which had to be estimated in detail, plus an agreed level of profit margin minus the expected revenue from the operation of the ferry service. There is a claw back clause stating that if the agreed profit margin is exceeded, the subsidy is reduced accordingly. This calculation is made for each of the 6 years of the contract before the beginning of the contract (hereinafter ‘the Base Case scenario’). The public service contract foresees a series of exceptional events that may trigger a revision of the compensation amount (e.g. unforeseen harbour works, new vessel, wage increases, etc.).

(175) On the other hand, at the end of each year of contract, the Base Case scenario will be reviewed to reflect the actual experience of the previous year. The Base Case scenario may also be revised during a given year in exceptional circumstances. The compensation may be increased or decreased several times during the contract period. The revision of the Base Case scenario is proposed by the operator (CalMac) and must be agreed by the Scottish Executive. There is also the possibility to refer the matter to an expert in case of disagreement. Although the public service contract contains some indications on how the compensation will be adjusted in the case of certain unforeseen circumstances, the exact parameters of these adjustments are not known in advance. The amount of compensation will rather be adjusted via a bilateral arbitration procedure between the Scottish authorities and CalMac, possibly involving the intervention of an expert. The criteria used in this

arbitration procedure are not set out in advance in an objective manner for all possible events. This arbitration procedure gives rise to a lack of transparency in the determination of the parameters for compensation. It also introduces a risk of variation in the compensation granted each year that is not dependent on transparent, predetermined and objective criteria.

(176) Therefore, the Commission cannot establish, beyond reasonable doubt, that the Altmark 2 condition is fulfilled.

Altmark 3 – no overcompensation (including reasonable profit)

(177) As indicated in the preceding section, the parameters for the compensation are in general clearly established, with the exception of the criteria used in the arbitration procedure foreseen under certain circumstances. Even though some parameters of the compensation are not precisely defined in advance, the Commission considers that the procedure in place to review the compensation amount in such circumstances is appropriate to ensure that there will be no overcompensation. This is because the possible additional compensation will be based on actual costs incurred. Thus, the Altmark 3 condition is fulfilled (see also Section 5.3.3.3 below).

Altmark 4 – tender procedure – in case of no tender, costs calculated by reference to typical undertaking

(178) In the present case the public service obligations were attributed following a public tender procedure.

(179) It must first be assessed whether the tender was well-designed, fair, open and transparent. Otherwise, the cost to the State could be higher than the minimum necessary for discharging the public service obligations.

(180) The main issues raised by interested parties in this context were the bundling of all routes in the tender, with the exception of Gourrock-Dunnon, and the requirement for the winning bidder to use CMAL’s vessels.

(181) As regards the bundling of routes, it was argued that this effectively excluded opponents since CalMac, which was already providing all the services, was the only bidder capable of making an offer for the entire bundle of routes.

(182) However there was a second bidder (V-Ships) which made a bid for the whole bundle. V-Ships eventually withdrew from the process arguing that the condition that CMAL’s vessels must be used prevented innovation and flexibility on the services to be provided.

⁽³⁵⁾ OJ C 13, 17.1.2004, p. 3.

- (183) The geographical area covered by the 26 routes is quite homogeneous: all routes are relatively short (maximum of around 100 kilometres) and the ports used are relatively concentrated (in a range of around 250 kilometres in the mainland).
- (184) The UK authorities provided credible arguments justifying the bundling of the 26 routes.
- (185) They argued that bundling ensures maximum flexibility of the fleet to best serve the network. For example in case of break-down of a vessel, the immediate provision of a relief vessel is critical to ensure the reliability of the lifeline services. Relief vessels are also needed in case of poor weather conditions, when vessels have to undertake maintenance works and when there is an unexpected need for increased capacity. At present, CalMac can organise a relief vessel often by managing a series of sequential movements of vessels between routes. It would be more difficult to ensure continuity of services and capacity optimisation if there were a range of operators serving the network.
- (186) Moreover, the bundling of all routes enhances integration of the network by making it easier combine safety, quality and environmental aspects of vessel and port operations and to ensure that standards are applied evenly across the network. The United Kingdom's Maritime & Coastguard Agency Regional Office for Scotland and Ireland has made it clear that the fragmentation of the network may not be the most efficient way to ensure the continuation of safe and reliable services.
- (187) Furthermore, bundling leads to economies of scale particularly in ticketing and marketing and supports integrated transport by allowing customers access to bookings on a series of routes in a single transaction. This also applies to tourism promotion.
- (188) It may be argued that in order to minimise costs, each route should be tendered out separately. However, the Commission acknowledges that the administrative costs and burden of such individual tendering (26 individual tenders) could be too high.
- (189) A mid-way solution, bundling only some routes might also be considered, but it would be speculative to predict whether the outcome of such tendering in terms of overall cost to the public budget would be higher or lower than the actual cost resulting from the bundled tender.
- (190) The Commission Communication on the interpretation of the Maritime Cabotage Regulation (Section 5.5.3) states that 'Member States often wish to group public service routes to and from different islands into a single bundle in order to generate economies of scale and attract operators. Bundles as such are not contrary to Community law provided that bundling does not lead to discrimination. The most appropriate size of bundles should be decided by taking account of the best synergy to be made in meeting essential transport needs.'
- (191) Given the legal framework which explicitly allows for the bundling of routes and the reasonable arguments presented by the UK authorities, it cannot be concluded that the bundling of routes is an unnecessarily unfair condition of the public tender and inevitably increases the cost to the State for discharging the public service obligations.
- (192) The requirement for the winning bidder to use CMAL's assets is a reasonable condition of the tender, taking into account that the Scottish authorities had a clear interest in using already available vessels rather than having to keep them unused or otherwise to dispose of these assets. The Communication on the interpretation of the Maritime Cabotage Regulation (Section 5.3.2.1) foresees that '... where Member States' authorities themselves own vessels or have them otherwise at their disposal, these may be placed at the disposal of all potential service operators under the same non-discriminatory terms.' Moreover, it is a neutral condition for bidders, given that any bidder would pay the same price for the use of the same vessels. Even though this requirement is legitimate, it may lead to an increased cost in the service. Indeed, it cannot be excluded that if bidders were free to present alternative vessel solutions, this might lead to lower overall net costs of the public service obligations.
- (193) Furthermore, given the specificities of the vessels needed to operate the Scottish western islands routes, it could be difficult for a single operator to have a new fleet of compliant vessels capable of serving all the routes and maintaining the links to remote island communities in time for the beginning of the contract period.
- (194) CalMac had a competitive advantage in the tender since it already served the routes, but it would be erroneous to conclude that because of this advantage the tender was unduly tailor-made and effectively excluded other bidders ⁽³⁶⁾.
- (195) Therefore, it is concluded that the tender procedure was conducted in an adequate manner and that it was open, non-discriminatory and transparent.
- ⁽³⁶⁾ There was in fact another bidder in the process.

(196) As mentioned above, the parameters for calculating the compensation are to be reviewed every year at least. This revision is in some cases the result of an arbitration process between the operator and the Scottish authorities. Consequently, there is a risk that the State will have to provide more (or less) funds to the operator than the compensation foreseen in its bid.

(197) If the invitation to tender had required the bidders to commit to a given fixed compensation for the 6 years of the contract, with all risks being assumed by them, the State would incur no risk and would theoretically minimise costs. However, it cannot be excluded that, if the bidders had to take on all the risks of the operation, there would be no undertakings willing to bid or that the bidders would bid much higher to price in the added risk.

(198) It cannot be concluded, beyond reasonable doubt, that the Altmark 4 condition is met.

Conclusion

(199) Given that it cannot be concluded beyond reasonable doubt that the Altmark 2 and 4 criteria are met the public service contract with CalMac is deemed to contain State aid elements.

5.1.2.2. NorthLink

(a) NorthLink 1 (2002-2006)

Altmark 1 – clearly defined public service obligations

(200) As mentioned in recital 170 above, in this particular sector there is a Regulation specifying which elements should be part of an adequate definition of public service obligations. The fulfilment of the Altmark 1 criterion should therefore be assessed with regard to Article 4 of the Maritime Cabotage Regulation.

(201) It is clear that the invitation to tender met this criterion by defining in detail all parameters referred to in the Maritime Cabotage Regulation, i.e. ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessels. This is confirmed by the Report of Audit Scotland of December 2005.

(202) The public service contract also had a duration below the 6 years recommended by the Maritime Guidelines.

Altmark 2 – ex ante, objective and transparent establishment of parameters for compensation

(203) On the one hand, before the public service obligations started being discharged, the parameters for compensation were rather clear. They were equal to the costs foreseen by the bidders, which had to be estimated in detail, plus an agreed level of profit margin minus the expected revenue from the operation of the ferry service. There was a claw back clause stating that if the agreed profit margin was exceeded, the extra profits would be shared with the Scottish Executive. Most of the economic/financial risks were to be borne by the winning bidder (risk of costs exceeding estimates, risk of falling demand, inflation risk, etc.).

(204) On the other hand, some risks remained with the Scottish Executive or were shared between the parties, notably the risk of policy changes (EU or national) and legislative risks (changes in corporate tax law, for example). The contract also required the Scottish Executive to pay additional grants to NorthLink 1 in case its return on capital was less than a certain rate or if other factors outside its control affected its revenue (e.g. increase in fuel prices by more than 10 %). Following the financial difficulties of NorthLink 1 in 2003 extra payments were made and in 2004 the MoA was signed, envisaging monthly payments to NorthLink 1 and the possibility for additional payments depending on NorthLink 1's financial performance.

(205) The possibilities for extra funding going beyond the level of compensation foreseen in the original contract were not established on the basis of ex ante, objective and transparent parameters, as shown by the subsequent need to provide additional funds outside the scope of the public service contract. In any case, the additional funding possibilities under the MoA and the additional payments made to NorthLink 1 following its financial difficulties were not based on objective and transparent parameters.

(206) Therefore, it cannot be established beyond reasonable doubt, that the Altmark 2 condition is fulfilled.

Altmark 3 – no overcompensation (including reasonable profit)

(207) As indicated in the preceding section, the parameters for the compensation were in general clearly established, with the exception of the criteria used in the arbitration procedure foreseen under certain circumstances. Even though some parameters of the compensation were not precisely defined in advance, the procedure in place to review the compensation amount in such circumstances was appropriate to ensure that there would be no overcompensation. Thus, the public service contract of NorthLink 1 respected the Altmark 3 condition.

Altmark 4 – public tender - in case of no tender, costs calculated by reference to typical undertaking

- (208) As in the case of CalMac analysed above (recital 178 above), NorthLink 1's public service obligations were entrusted following a public tender procedure.
- (209) It must therefore be assessed whether the tender was well-designed, fair, open and transparent. Otherwise, the cost to the State could be higher than the minimum necessary for discharging the public service obligations.
- (210) The tender procedure covered two routes (26 routes in the case of CalMac analysed above – see recitals 183-191 above). The bundling issue is therefore less relevant in the case of NorthLink 1 and NorthLink 2 than in the case of CalMac. For the same reasons invoked above with regard to CalMac, the Commission does not consider that the bundling of the two routes calls into question the open, non-discriminatory and transparent character of the tender.
- (211) However, the subsidies granted to NorthLink 1 under the MoA, which went beyond the level of compensation foreseen in the original contract, were not the result of a public tender and were not determined on the basis of an analysis of the costs of a typical undertaking. In fact, by introducing a new deficit funding system during the implementation of the contract, the MoA in fact altered the nature and extent of the initial tender, thereby affecting its transparency in relation to the way it had been presented to potential bidders.
- (212) Accordingly, it cannot be concluded beyond reasonable doubt that the Altmark 4 criterion is met.

Conclusion

- (213) Given that it cannot be concluded beyond reasonable doubt that the Altmark 2 and 4 criteria are met, the public service contract with NorthLink 1 is deemed to contain State aid elements.

(b) NorthLink 2 (2006-2012)

Altmark 1 – clearly defined public service obligations

- (214) As mentioned above, in this particular sector there is a Regulation specifying what elements should be part of an adequate definition of public service obligations. The fulfilment of the Altmark 1 criterion should therefore be assessed with regard to Article 4 of the Maritime Cabotage Regulation.
- (215) It is clear that the invitation to tender met this criterion by defining in detail all parameters referred to in the Maritime Cabotage Regulation, i.e. ports to be served,

regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessels.

- (216) The public service contract also has a reasonable duration – 6 years – in compliance with the Maritime Guidelines.

Altmark 2 – ex ante, objective and transparent establishment of parameters for compensation

- (217) On the one hand, before the public service obligations started being discharged, the parameters for compensation were rather clear. They were equal to the costs foreseen by the bidders, which had to be estimated in detail, plus an agreed level of profit margin minus the expected revenue from the operation of the ferry service. There is a claw back clause stating that if the agreed profit margin is exceeded, the extra profits would be shared with the Scottish Executive. In this second contract with NorthLink 2, more risks are borne by the Scottish Executive or shared between the parties (weather risk, inflation risk, risk of falling demand, change in transport policy, etc.).
- (218) On the other hand, similar to the 2007 public service contract with CalMac, subsidy amounts are to be reviewed annually on the basis of the actual performance in the previous year. The operator will submit a provisional draft revised Base Case scenario which then has to be agreed by the Scottish authorities. In case of conflict an expert is called upon to arbitrate. Although the public service contract contains some indications as to how the compensation will be adjusted in the case of certain unforeseen circumstances, the exact parameters of these adjustments are not known in advance. The amount of compensation will rather be adjusted via a bilateral arbitration procedure between the Scottish authorities and NorthLink 2, possibly involving the intervention of an expert. The Commission notes that the criteria used in this arbitration procedure are not set out in advance in an objective manner for all possible events. This arbitration procedure gives rise to a lack of transparency in the determination of the parameters for compensation. It also introduces a risk of variation in the compensation granted each year that is not dependent on transparent, predetermined and objective criteria. Therefore, it cannot be established beyond reasonable doubt that the Altmark 2 condition is fulfilled.

Altmark 3 – no overcompensation (including reasonable profit)

- (219) As indicated in the preceding section, the parameters for the compensation are in general clearly established, with the exception of the criteria used in the arbitration procedure foreseen under certain circumstances. Even though some parameters of the compensation are not precisely defined in advance, the procedure in place to review the compensation amount in such circumstances

is appropriate to ensure that there will be no over-compensation. This is because the possible additional compensation will be based on actual costs incurred. Thus, the Altmark 3 condition is fulfilled (see also Section 5.3.4.3 below).

Altmark 4 – public tender – in case of no tender, costs calculated by reference to typical undertaking

- (220) In the present case the public service obligations were attributed following a public tender procedure.
- (221) It must first be assessed whether the tender was well-designed, fair, open and transparent. Otherwise, the cost to the State could be higher than the minimum necessary for discharging the public service obligations.
- (222) As with NorthLink 1, the bundling of the two routes calls into question the open, non-discriminatory and transparent character of the tender.
- (223) As in the case of CalMac, the requirement for the winning bidder to use the vessels of NorthLink 1 is a reasonable condition of the tender, taking into account that the Scottish Executive had a clear interest in using already available vessels rather than having to keep them unused or otherwise to dispose of these assets. Moreover, it is a neutral condition for bidders, given that any bidder would pay the same price for the use of the same vessels. Even though this requirement is legitimate, it may lead to a higher cost of the service. Indeed, it cannot be excluded that if bidders were free to present alternative vessel solutions, this might lead to lower overall net costs of the public service obligations.
- (224) For these reasons and in line with the assessment above regarding CalMac ⁽³⁷⁾, the Commission cannot conclude, beyond reasonable doubt, that the Altmark 4 criterion is met.

Conclusion

- (225) Given that it cannot be concluded beyond reasonable doubt that the Altmark 2 and 4 criteria are met, the public service contract with NorthLink 2 is deemed to contain State aid elements.

5.2. NATURE OF THE AID

5.2.1. GENERAL CONSIDERATIONS

- (226) Having established that the payments granted to CalMac, NorthLink 1 and NorthLink 2 constitute State aid within the meaning of Article 87(1) of the Treaty, the Commission must assess whether this State aid is existing or whether it constitutes new aid. In this respect, it should be noted that when initiating the

formal investigation procedure the Commission did not address the question whether the aid should be considered as new or existing aid.

- (227) As mentioned previously ⁽³⁸⁾, during the course of the formal investigation procedure, it became apparent, however, that part of the aid might be considered as existing aid in view of the date of entry into force of the legal provisions providing for the aid. Therefore, the Commission decided to initiate, in parallel to the formal investigation procedure, the cooperation procedure foreseen pursuant to Article 17 of the Procedural Regulation.
- (228) In the case of existing State aid, the Commission is only required to check its compatibility at present and recommend possible changes for the future. Inversely, in the case of new aid, the Commission is required to check its compatibility with the common market also in the past.
- (229) Pursuant to Article 1(b)(i) of the Procedural Regulation as amended, existing aid is ‘... without prejudice to Articles 144 and 172 of the Act of Accession of Austria, Finland and Sweden, to Annex IV, point 3 and the Appendix to said Annex to the Act of Accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia, and to Annex V, point 2 and 3(b) and the Appendix to said Annex to the Act of Accession of Bulgaria and Romania, all aid which existed prior to the entry into force of the Treaty in the respective Member States, that is to say, aid schemes and individual aid which were put into effect before, and are still applicable after, the entry into force of the Treaty.’
- (230) According to Article 4(1) of Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty ⁽³⁹⁾ (hereinafter ‘the Implementing Regulation’), ‘... an alteration to existing aid shall mean any change, other than modifications of a purely formal or administrative nature which cannot affect the evaluation of the compatibility of the aid measure with the common market.’
- (231) According to the established case-law ⁽⁴⁰⁾, not every alteration to existing aid should be regarded as changing the existing aid into new aid. In that case, the Court of First Instance held ‘... it is only where the alteration affects the actual substance of the original scheme that the latter is transformed into a new aid scheme. There can be no question of such a substantive alteration where the new element is clearly severable from the initial scheme.’

⁽³⁸⁾ See recital 9 above.

⁽³⁹⁾ OJ L 140, 30.4.2004, p. 1.

⁽⁴⁰⁾ Judgment of the Court of First Instance of 30 April 2002 in joined cases T-195/01 and T-207/01, *Gibraltar v Commission* [2002] ECR II-2309.

⁽³⁷⁾ See recitals 178-198 above.

- (232) The Court of First Instance has also clarified that ‘... whether aid may be classified as new aid or as alteration of existing aid must be determined by reference to the provisions providing for it’⁽⁴¹⁾. When the relevant legal provisions have not been changed as regards the nature of the advantage or the activities of the beneficiaries, there is no new aid.
- (233) Therefore, it should be assessed, by reference to the legal framework and to the evolution of the scheme, whether there have been substantial changes since the United Kingdom’s accession to the EU in 1973 that would involve new aid. The case law refers to changes in the nature of the advantage, the objective pursued, the beneficiary or the source of financing.
- (234) It should also be assessed whether subsequent modifications are severable from the original measure or whether the non-severable changes affect the actual substance of the original legal framework, i.e. the nature of the advantage or the source of financing, the purpose or legal basis of the aid, the beneficiaries or the scope of activities of the beneficiaries so that the latter as a whole is transformed into a new aid.
- 5.2.2. CALMAC
- (235) CalMac has been providing ferry shipping services in the western Scottish islands long before the UK accession to the European Community in 1973.
- (236) The initial legal basis for the subsidies was Section 2(1) of the Highlands and Islands Shipping Services Act of 1960 which allowed the Scottish Ministers⁽⁴²⁾ to provide grants/loans to persons providing public sea transport services. Sections 2(3) and 2(4) of the Act provided that an ‘Undertaking’ (which took the form of subordinate legislation in practice) had to be used when such a grant/loan exceeded GBP 10 000 and that any such Undertaking had to be approved by the Scottish Parliament⁽⁴³⁾.
- (237) Section 45(1) of the Transport (Scotland) Act of 2005, which came into force on 10 October 2005 repealed those provisions of the 1960 Act but Section 45(2) provided that any Undertaking which had been entered into before 10 October 2005 would continue to have effect. This meant that the Undertaking dated 7 April 1995 entrusting the public service obligations to CalMac continued to have effect after the entry into force of the 2005 Act.
- (238) Since 1 October 2006, when the restructuring of the CalMac group took place and a new legal entity was created to operate the Gourock-Dunoon route, compensation for the public service obligations in this route is based on Section 70(1) of the Transport (Scotland) Act of 2001 as amended by the Transport Scotland Act of 2005.
- (239) Until 1 October 1997, when the Clyde and Hebrides ferry services contract entered into force, the public service obligations were specified in annual letters from the Scottish Ministers to CalMac (regularity, frequencies, capacities, fare rates and subsidy amount).
- (240) Since 1 October 2007, the specifications of the public service obligations are part of the public service contract which followed a public tender procedure, except for the Gourock-Dunoon route.
- (241) As regards the Gourock-Dunoon route, since 1 October 2007 the subsidy requirements have been determined administratively on the basis of the Scottish Ministers’ approvals of the company’s annual financial plans and the in-year monitoring by the Scottish Government of actual deficit requirements.
- (242) In light of the above, the Commission is of the opinion that the purpose of the aid scheme has clearly remained constant since the inception of the scheme. It is to provide ferry transport services between the Scottish islands.
- (243) The evolution of the legal basis of the scheme did not materially change the nature of the advantage given to CalMac since 1973. CalMac has continuously been receiving deficit grants, capital grants and loans (for piers and harbours infrastructure and for vessels). The source of this financing has also not changed as all funds continue to come from the national budget.
- (244) There have been regular increases in the amount of annual compensation. These increases should not, however, be regarded as new aid. As the Court of Justice has stated⁽⁴⁴⁾ ‘... the emergence of new aid or the alteration of existing aid cannot be assessed according to the scale of the aid or, in particular, its amount in financial terms at any moment in the life of the undertaking if the aid is provided under earlier statutory provisions which remain unaltered.’

⁽⁴¹⁾ Judgment of the Court of Justice of 9 August 1994 in case C-44/93, *Namur-Les Assurances du Crédit* [1994] ECR I-3829.

⁽⁴²⁾ Before devolution in 1999 the Scottish Office, a Department of the UK Government.

⁽⁴³⁾ Before devolution the UK Parliament.

⁽⁴⁴⁾ See footnote 41.

(245) The Commission is of the view that the increasing aid amounts are the consequence of increased financial needs of the public service provider in fulfilling its public service mission, while the public service obligations, the funding arrangements and the amendments to the statutory provisions for the compensation have not suffered material changes.

(246) The beneficiary of the measure has been the same since the beginning of the scheme. Although CalMac underwent a restructuring process in 2006, it has always been the sole beneficiary of the aid and has always been a fully-owned public company. In 2006 its vessel and shore assets were separated from its ferry operating role. This change cannot be seen as altering the beneficiaries of the scheme as the two separate legal entities continue to be the only interveners in the compensation scheme. This legal separation is a change of technical nature that does not lead to a material change of beneficiary of the aid.

(247) Likewise, the attribution of the operations on the Hebrides and Clyde to two separate legal entities (CalMac Ferries Ltd and Cowal Ferries Ltd, two wholly-owned subsidiaries of David MacBrayne Ltd) must be seen as a change of technical nature that does not lead to a material change of beneficiary of the aid.

(248) There have been some adaptations to the overall service and routes served by CalMac. A few new services were added while a few others were discontinued. One of these adaptations, for example, resulted from the opening of a new bridge which rendered the existing service superfluous. The Commission considers that these are technical changes intended to adapt the public service offer to the needs of the population. These adaptations did not change the overall purpose of the scheme. The public service obligations are defined as a whole and limited technical adjustments to the routes served do not materially change the essence of the scheme.

(249) For the reasons set out above, the Commission has concluded in the course of its investigation that the aid scheme concerning CalMac constitutes an existing aid ⁽⁴⁵⁾ and initiated the co-operation procedure provided for pursuant to Article 17 of the Procedural Regulation in parallel to the formal investigation procedure. It informed the Member State about this conclusion and expressed its preliminary view that some aspects of the scheme were no longer compatible with the common market. The Member State's authorities were given the opportunity to submit their comments on this preliminary view.

⁽⁴⁵⁾ For a similar reasoning, see Commission decision of 28 January 2009 in case E 4/2007 - France - Différenciation des 'redevances par passager' sur certains aéroports français, especially Section 4 thereof.

(250) Since the State aid scheme in favour of CalMac is an existing aid, its compatibility must accordingly be assessed exclusively by reference to the present situation ⁽⁴⁶⁾ and the Commission is not required to assess the compatibility of the aid granted to CalMac in the past.

5.2.3. NORTHLINK

(251) It is clear that the payments made to NorthLink 1 under the public service contract for the operation of the Northern islands routes in the period 2002-06 and under the MoA constitute new aid since NorthLink 1 was not developing any public service activities in these routes before 2002.

(252) Similarly, the payments made to NorthLink 2 constitute new aid, independently from the question whether NorthLink 1 and NorthLink 2 should be seen as separate beneficiaries or whether NorthLink 2 should be considered as a mere continuation of NorthLink 1.

(253) Therefore, all aid paid from 2002 to NorthLink 1 and NorthLink 2 must be considered as new aid.

(254) The compatibility of the scheme with the common market must therefore be assessed for the period since 2002.

5.3. COMPATIBILITY

5.3.1. APPLICABILITY OF ARTICLE 86(2) OF THE TREATY

(255) Article 86(2) of the Treaty is the legal basis to assess the aid granted to CalMac, NorthLink 1 and NorthLink 2.

(256) Pursuant to Article 86(2) of the Treaty, it must be assessed whether:

— the ferry services in Scotland constitute SGEI and are clearly defined as such by the UK authorities (definition) ⁽⁴⁷⁾;

— CalMac, NorthLink 1 and NorthLink 2 are explicitly entrusted by the Member State with the provision of that service and are subject to supervision as to the fulfilment of their tasks (entrustment and supervision);

⁽⁴⁶⁾ Meaning the situation from the date of entry into force of the 2007 public service contract with CalMac, except in the case of the Gourock-Dunoon route, for which the relevant situation dates back to the inception of the service.

⁽⁴⁷⁾ In addition, the public service contract must be concluded on a non-discriminatory basis according to the Maritime Cabotage Regulation.

— the funding is proportionate to the net cost of providing the public service, taking also into account other direct or indirect revenues derived from the public service, and does not lead to unnecessary distortions of competition or effects on trade (proportionality).

5.3.2. APPLICABILITY OF SGEI FRAMEWORK ⁽⁴⁸⁾/SGEI DECISION ⁽⁴⁹⁾

(257) As from its entry into force, the SGEI Decision exempts from the notification requirement public compensation for the performance of SGEI under certain conditions. The SGEI Framework lays down the conditions for compatibility of measures subject to the notification requirement as from its entry into force.

(258) The SGEI Framework explicitly excludes the transport sector in its point 3 and is therefore not applicable in the present case. Nevertheless, the principles of interpretation formulated therein can be useful in assessing the compatibility of the measures under analysis, given the general context of application of Article 86(2) of the Treaty ⁽⁵⁰⁾.

(259) The SGEI Decision does not exclude maritime and air transport. In the decision to open the formal investigation procedure, the possible application of the SGEI Decision was raised and the Commission expressed the preliminary position that it did not appear to be applicable in the present case.

(260) There are two exceptions from the notification requirement in Article 2 of the SGEI Decision which might be relevant in the present case:

‘(a) public service compensation granted to undertakings with an average annual turnover before tax, all activities included, of less than EUR 100 million during the two financial years preceding that in which the service of general economic interest was assigned, which receive annual compensation for the service in question of less than EUR 30 million’;

‘(c) public service compensation for air or maritime links to islands on which average annual traffic during the two financial years preceding that in which the service of general economic interest was assigned does not exceed 300 000 passengers’.

⁽⁴⁸⁾ Community framework for State aid in the form of public service compensation (OJ C 297, 29.11.2005, p. 4).

⁽⁴⁹⁾ See recital 119.

⁽⁵⁰⁾ In this context, State aid rules in the air transport sector already refer specifically to the principles of the SGEI Framework (see paragraph 67 and footnote 2 of the Commission Communication of 9 December 2005 ‘Community guidelines on financing of airports and start-up aid to airlines departing from regional airports’ (OJ C 312, 9.12.2005, p. 1)).

(261) The question of which entity should be considered for the application of condition (a) above (CalMac, NorthLink 1 and NorthLink 2 separately or together) was raised in the decision to open the formal investigation procedure.

(262) The Commission notes that both CalMac and NorthLink 2 are currently receiving more than EUR 30 million each per year in compensation for the operation of the respective maritime routes ⁽⁵¹⁾. Therefore, condition (a) is not met.

(263) As regards NorthLink 2, the latest data available shows traffic of 301 000 in 2004/2005 for the two routes served. For CalMac, the figures are much higher. Therefore, condition (c) is not met either.

(264) In conclusion, the Commission confirms its preliminary assessment that the SGEI Decision is not applicable in the present case.

5.3.3. EXISTING AID GRANTED TO CALMAC

5.3.3.1. *Definition*

(a) **Hebrides and Clyde (excluding Gourock-Dunoon)**

(265) As mentioned previously (see Section 5.2 above), only the current situation is relevant for the compatibility assessment of the aid granted to CalMac, since it is an existing aid. Thus, only the provisions of the 2007 public service contract have to be assessed for all routes, except for Gourock-Dunoon, which is excluded from this contract. In accordance with the co-operation procedure provided for pursuant to Article 88(1) of the Treaty the Commission has obtained from the United Kingdom all necessary information for the review of the existing aid scheme.

(266) The assessment made above with regard to the fulfilment of the Altmark 1 criterion applies here as well. The 2007 public service contract, which followed an open and transparent public tender procedure, is in accordance with Article 4 of the Maritime Cabotage Regulation, which sets out the specifications that should be part of the definition, namely: ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessels.

⁽⁵¹⁾ The compensation paid to CalMac and NorthLink 2 for the 2007/2008 financial exercise was GBP 45,3 and GBP 30 million, respectively (see tables 1 and 4 above).

(267) The public service contract sets out that the obligations imposed upon the Operator shall not preclude it from using the vessels for any other purposes provided that the obligation to provide the SGEI has been and continues to be satisfied. In practice, this allows the Operator, for example, to carry commercial vehicles, which is an activity outside the scope of its public service tasks. This condition in no way constitutes a manifest error in the definition of the SGEI attributed to CalMac, since it refers to activities outside the scope of the definition of the SGEI that may be carried out by CalMac on commercial terms (without State subsidisation).

(b) Gourock-Dunoon

(268) Since the Gourock-Dunoon route was excluded from the 2007 public service contract, the legal basis for the compensation related to this route continues to be the Highlands and Islands Shipping Services Act of 1960 as amended by Section 70 of the Transport (Scotland) Act 2001 and by Section 45 of the Transport (Scotland) Act 2005.

(269) The public service obligations for this route and the respective compensation are intended for the transport of passengers only, commercial vehicles being excluded. However, CalMac is free to provide transport services for commercial vehicles on purely commercial terms.

(270) The definition of the public service obligations is not in line with Article 4 of the Maritime Cabotage Regulation. Indeed, the basic characteristics of the public service such as the ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessels, are not formally defined in a legal Act.

(271) It has been argued by interested parties that the definition of the public service obligations in the Gourock-Dunoon route constitutes a manifest error by reference to a competing service. Indeed, there is another company – Western Ferries – providing transport services (passenger, vehicle and freight) in a similar route serving broadly the same locations, although starting and ending on different points. McGill's Buses (a local bus operator) has introduced a connecting bus service from Dunoon town centre that takes foot passengers directly onto Western Ferries' service and then drops passengers off in Glasgow city centre via Gourock.

(272) The United Kingdom has provided credible information on the adequacy of a SGEI for passenger transport on this route. While they recognise that McGill's buses and Western Ferries do provide a 'through' service for foot passengers on a very limited number of sailings, their characteristics in terms of frequency, convenience, travel time, transport integration, reliability and access for passengers mean that they are not substitutable to the

service provided by CalMac. Thus, there is a sound economic and social justification for public support for a town centre to town centre passenger service.

(273) The CalMac service offers higher frequencies – 18 return trips on weekdays compared to 8 return trips (mostly at peak times) offered by McGill's buses and the latter does not offer a Sunday service. The overall journey time is lower for the CalMac service especially at off-peak times (sometimes up to 50 % higher journey times for the McGill's service). The CalMac service is also closely integrated with the rail connection to Glasgow unlike the Western Ferries timetable. The CalMac service is also less prone to delays and disruption than the bus-ferry-bus competing service (e.g. mechanical breakdowns of buses or delays caused by traffic congestion or road works can affect the reliability and travel time of the competing service).

(274) Western Ferries itself recognises that 'the future for any subsidised service to Dunoon can only be the continuation of the passenger-only public service obligations, provided by passenger-only vessel/vessels'. Western Ferries currently accounts for 68 % of passenger carryings while it accounts for 86-88 % of commercial and car traffic. This shows that CalMac is playing a significant role in passenger traffic, while less so in commercial and car traffic.

(275) The role of the Commission pursuant to Article 86(2) of the EC Treaty must be limited to checking for manifest errors in the definition of SGEI. Although there is another competing service for passenger traffic in the same route, this other service is not substitutable to CalMac's service and the distinctive features of the latter do not warrant the conclusion that there has been a manifest error in the definition of the public service obligations.

(276) One related issue raised by Western Ferries is that CalMac is allowed to operate combined vehicle and passenger vessels on this route, while the public service obligations cover only passenger traffic. Western Ferries claims that this gives rise to cross-subsidisation and unfair competition and that therefore the public service obligations should be discharged on the basis of a passenger-only vessel.

(277) Pursuant to Article 86(2) of the EC Treaty this cannot be considered as a manifest error in the definition of the SGEI. Operators entrusted with public service obligations can also develop unsubsidised commercial activities. Where they do carry out commercial activities, they must meet certain requirements, such as separation of accounts, an adequate allocation of common costs and the absence of cross-subsidisation between the two types of activities.

(278) Provided that these requirements are met in the present case, the Commission cannot impose that the SGEI be provided via a passenger-only vessel. It cannot be denied that in the present case the commercial and public service activities are very closely linked – the same vessels provide public service and commercial services simultaneously – and share most of the costs. This indicates the need for special vigilance with regard to the separation of accounts and the cost allocation mechanism⁽⁵²⁾. However, it does not amount to a manifest error in the definition of the public service.

(279) In conclusion, the definition of the public service obligations is not in line with Article 4 of the Maritime Cabotage Regulation. Indeed, the basic characteristics of the public service such as the ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessels, are not formally defined in a legal Act. Therefore, the current definition of the SGEI for the operation of the Gourock-Dunoon route constitutes a manifest error.

(280) However, in principle it is possible in the future to legitimately define a SGEI for passenger transport on this route, including the possibility for the provider to carry out commercial activities on the basis of a combined passenger/vehicle vessel. This would not *as such* constitute a manifest error, provided that its characteristics are precisely defined in a legal Act.

(281) As mentioned above, the United Kingdom informed the Commission that they would launch a new open, transparent and non-discriminatory public tender for a passenger-only public service contract for this route, as the implementation of an appropriate measure.

(282) Therefore, it is up to the United Kingdom to ensure that this public tender will contain an appropriate definition of the public service obligations that is compatible with Article 86(2) of the Treaty. The Commission will monitor whether the appropriate measure as accepted by the United Kingdom is correctly implemented.

5.3.3.2. *Entrustment*

(a) **Hebrides and Clyde (excluding Gourock-Dunoon)**

(283) It seems evident that CalMac has been explicitly entrusted with the provision of the public service in question. The 2007 public service contract contains precise indications about the services that CalMac has to provide and on how the scope of the public service remit may be changed.

(284) The public service contract also contains clear provisions on the control of the execution of the public service by imposing regular detailed information from CalMac to the Executive about the operation of the routes. There are performance indicators which are regularly assessed, for example. If the performance standards are not met, then the grant may be reduced accordingly.

(b) **Gourock-Dunoon**

(285) In the case of the Gourock-Dunoon route, the Commission considers that CalMac has not been adequately entrusted with the operation of this route. Indeed, apart from the fact that the SGEI is currently not well defined, there are no clear legal provisions laying down the conditions under which CalMac must provide this SGEI. There are also no clear provisions for the calculation of the compensation or performance indicators that would affect the annual grant, for example. Therefore, the entrustment of this route to CalMac is currently not sufficiently clear and comprehensive.

(286) It is up to the UK authorities to ensure that, in the context of the new public tender for a passenger-only public service contract for this route, the public service obligations will be clearly entrusted to the winning bidder.

5.3.3.3. *Proportionality*

(a) **Hebrides and Clyde (excluding Gourock-Dunoon)**

(287) Since the State aid granted to CalMac until now is considered to be an existing aid, the Commission does not need to assess whether there has been any overcompensation of CalMac's public service obligations in the past. Therefore, the assessment must be forward-looking. It must exclusively be assessed whether the provisions of the 2007 public service contract provide sufficient guarantees to avoid over compensation and possible anti-competitive behaviour by CalMac.

(288) As mentioned above⁽⁵³⁾, the public tender was carried out in an open and transparent way.

(289) The provisions of the public service contract are appropriate to prevent over compensation for the performance of the public service obligations. Compensation is limited to operating costs minus operating revenues (including reasonable profit). The costs which are eligible for compensation are also clearly defined in the public service contract.

⁽⁵²⁾ See also in this context recitals 295 to 298 of this Decision.

⁽⁵³⁾ See recitals 178-198 where compliance with Altmark criterion 4 is assessed. Although that condition is not met, the tender is considered as sufficiently open and transparent, according to the criteria laid down in the Maritime Cabotage Regulation.

- (290) There is a claw back mechanism that will return the major part of any potential excess compensation to the Scottish authorities. Only a small amount is not returned. For example, if over compensation is GBP 1 million, only GBP 275 000 will be kept by CalMac. In case over compensation is GBP 10 million, only GBP 725 000 will be kept by CalMac. This system is intended to create an incentive for CalMac to reduce costs and be more efficient. These amounts are very limited and in accordance with the definition of 'reasonable profit' laid down in the SGEI Framework (point 18 thereof) ⁽⁵⁴⁾. Although the SGEI Framework does not apply in the present case, the Commission considers that the potential excess compensation amounts that may be retained by CalMac are very limited and proportional with regard to the compensation amounts.
- (291) Furthermore, the profit margin foreseen in the public service contract results from a competitive bidding procedure and so it is ensured that this margin is set at a reasonable level.
- (292) There is also a clause in the public service contract which ensures that, in case the public service provider receives further public support from other sources, the grant under the terms of the contract will be reduced accordingly.
- (293) In conclusion, the public service contract contains sufficient safeguards against over compensation for the performance of the public service obligations.
- (294) Besides the issue of over compensation, the Commission has also assessed, in the light of the complaints received on this aspect, whether the public service contract contains sufficient safeguards to avoid anti-competitive behaviour by CalMac that might cause undue distortions of competition. This would be the case, for example if CalMac were in a position to consistently undercut competitors' prices, thereby driving them away from the market.
- (295) In this context, it must be underlined that there is currently no competition at all on these routes. Also, the public service contract sets strict conditions on the pricing of the tickets. It includes the schedule of the prices for 2007/08 and imposes consultation of the Scottish authorities in case prices are reviewed. In particular, CalMac would infringe the provisions of the public service contract if it were to unilaterally and unjustifiably reduce prices to drive existing competitors out of the market or to foreclose the entry of potential competitors. Moreover, no additional compensation can be claimed by CalMac for any reduction in revenue arising from discounts or reductions in the prices established in the published tariff schedule. This also prevents possible anti-competitive price behaviour.
- (296) Another possible distortion of the market would occur if the public service provider could, acting alone, significantly modify or increase its public service offer, for example by adding new routes or significantly increasing frequencies. If CalMac would automatically be eligible for further compensation for these added services, this might cause an unwarranted distortion of competition beyond what can reasonably be accepted as counterpart for the fulfilment of the public service obligations.
- (297) The public service contract explicitly provides for prior consultation and approval by the Scottish Ministers before any major adjustments are made to the published timetables and frequencies or to the agreed services.
- (298) There are also specific provisions in the public service contract which prohibit the public service provider from cross-subsidising between its public service and non-public service activities and requiring all transactions between CalMac and its subsidiaries to be carried out on an arms length basis.
- (299) Almost all of CalMac's activities fall under the scope of the public service contract. Nevertheless, in order to ensure transparency, there must be separation of accounts between its public service activities and its non-public service or commercial activities in compliance with the provisions of the Transparency Directive ⁽⁵⁵⁾.
- (300) Under the terms of the public service contract, CalMac must report, on a yearly basis, on the actual costs incurred with the provision of the public service tasks. This 'Actual Outcome Statement' isolates the public service costs from the rest of CalMac's activities. Therefore, it is ensured that the amount of public funds allocated to CalMac and the use of those funds are clearly distinguished from the remainder of CalMac's activities. The public service contract provides explicitly for the need to keep clear, separate and transparent accounting systems for the financing and operating of the public service activities.

⁽⁵⁴⁾ By way of comparison, where over compensation amounts to GBP 10 million (a very unlikely and unprecedented scenario), the GBP 725 000 CalMac would retain would represent only around 1,7 % of the annual compensation paid to CalMac in 2007/2008 and a much lower proportion of total revenues.

⁽⁵⁵⁾ Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (OJ L 318, 17.11.2006, p. 17).

- (301) In order to ensure that the costs incurred with the public service activities are clearly distinguished from the costs incurred with other activities, it is also necessary to put in place an appropriate system for allocating costs which are common to both types of activities.
- (302) The public service contract contains in detail all the costs that are admissible for compensation. Besides the deficit grant, which is intended to cover all the operating costs associated with the operation of the public service (e.g. CMAL vessel lease costs, seagoing personnel costs, fuel, terminal traffic dues, ticketing, insurance, etc.), supplements are foreseen for unexpected fuel cost rises and for capital expenditures (e.g. acquisition of assets for the provision of the public service activities, harbour works for the same purpose, etc.). All the costs covered by the deficit grant are precisely quantified in the Base Case scenario and the conditions for applying and for determining the potential fuel supplements and capital supplements are precisely defined in the public service contract.
- (303) Therefore, that the public service contract is sufficiently clear as regards the allocation of costs between public service and non-public service activities.
- (304) In accordance with its normal practice regarding existing aid schemes, the Commission will continue to monitor CalMac's activities and, in particular, the proper allocation of costs, the avoidance of cross-subsidisation and the full transparency with regard to the separation of accounts.
- (305) The Commission positively notes in this context that the UK authorities intend to publicly consult interested parties whenever substantial changes are introduced in the public service obligations of CalMac for the Hebrides and Clyde routes. They will also require CalMac to produce separate audited profit and loss accounts for public service activities and for commercial activities starting in the 2009/2010 financial year and intend to include such requirements in all future public service contracts for ferry services in the Hebrides and Clyde.
- (b) Gourock-Dunoon**
- (306) Western Ferries claimed that a passenger-only service based on a passenger-only vessel would save taxpayers' money by reducing the amount of the annual subsidy to CalMac. However, Article 86(2) of the Treaty does not require the Member State to choose the most cost efficient way of delivering the public service.
- (307) In the case of the Gourock-Dunoon route, there are no clear provisions for avoiding over compensation, no explicit safeguards against anti-competitive behaviour or cross-subsidisation and no formal requirement for the separation of accounts or provisions for cost allocation.
- (308) Therefore, as regards the Gourock-Dunoon route, there are not sufficient guarantees that the aid is proportional to the public service obligations of CalMac and that therefore appropriate measures are necessary to render the aid compatible for the future.
- (309) The UK authorities accepted, as an appropriate measure, to organise a public tender procedure. In the context of the existing aid scheme for this route, the Commission finds that when implementing the public tender procedure the UK authorities have to ensure that this tender for a passenger-only public service contract for the Gourock-Dunoon route includes clear provisions for avoiding over compensation and explicit safeguards against anti-competitive behaviour and cross-subsidisation, including the obligation to consult publicly interested parties on major changes to the public service remit. A formal requirement for the separation of accounts and appropriate provisions for cost allocation are also required.
- (310) The Commission also notes positively in this context that the UK authorities intend to publicly consult interested parties whenever substantial changes are introduced in the public service obligations of CalMac for the Gourock-Dunoon route. They will also require CalMac to produce separate audited profit and loss accounts for public service activities and for commercial activities starting in the 2009/2010 financial year and intend to include such requirements in all future public service contracts for ferry services in the Gourock-Dunoon route.
- 5.3.3.4. Conclusion on the existing aid part**
- (a) Hebrides and Clyde (excluding Gourock-Dunoon)**
- (311) The SGEI for the operation of the Clyde and Hebrides routes, with the exception of Gourock-Dunoon, is well defined and has been duly entrusted to CalMac. There are sufficient safeguards to ensure that the compensation granted to CalMac is proportional to its public service obligations. Thus, the State aid granted to CalMac for the operation of these routes is compatible with Article 86(2) of the EC Treaty.
- (b) Gourock-Dunoon**
- (312) The public service for the operation of the Gourock-Dunoon route is not sufficiently well defined and has not been entrusted in a sufficiently precise and transparent way. There are insufficient safeguards to ensure that the compensation granted to CalMac is proportional to its public service obligations. Thus, the State aid granted to CalMac for the operation of the Gourock-Dunoon route is incompatible with Article 86(2) of the Treaty.

- (313) The Commission notes that the UK authorities, under the co-operation procedure foreseen for existing aid schemes, have accepted as an appropriate measure to launch a new open, transparent and non-discriminatory public tender for a passenger-only public service contract for this route along the lines described above. According to Article 19 of the Procedural Regulation, the Member State shall be bound by its acceptance to implement the appropriate measure.
- (314) In order to ensure compatibility of the public service for this route with Article 86(2) of the EC Treaty, the implementation needs to take place according to the following requirements: the tender and the subsequent public service contract must be launched within a reasonable time period; must contain a clear and precise definition of the public service obligations; must provide for a full and detailed entrustment of the public service provider; must contain appropriate safeguards for preventing over-compensation, cross-subsidisation and anti-competitive behaviour (including the obligation to consult publicly interested parties on major changes to the public service remit) and contain clear provisions on cost allocation and separation of accounts.
- (315) For the reasons mentioned above, it must be concluded, in accordance with Article 18 of the Procedural Regulation, that the existing aid for this route is no longer compatible with the common market. Pursuant to Article 18 of the Procedural Regulation, the appropriate measures mentioned above and their correct implementation should ensure future compatibility of the aid with Community law.
- (316) By letter of 15 May 2009, the UK authorities have committed to initiate the procedures required for launching a public tender for this route before the end of 2009, thereby accepting the appropriate measures proposed. The subsequent public service contract should start before end-June 2011.
- (317) The Commission notes in this context that the UK authorities intend to publicly consult interested parties whenever substantial changes are introduced in the public service obligations of CalMac for the Gourock-Dunoon route. They will also require CalMac to produce separate audited profit and loss accounts for public service activities and for commercial activities starting in the 2009/2010 financial year and intend to include such requirements in all future public service contracts for ferry services in the Gourock-Dunoon route.
- (318) In view of the above and in accordance with Article 19 of the Procedural Regulation, the Commission records the acceptance of the appropriate measures by the UK authorities and considers that, subject to the correct implementation of the appropriate measures as described above, the scheme will be in compliance with Article 86(2) of the Treaty. Thus, the compatibility of the scheme with the EC Treaty is subject to the verification by the Commission that the appropriate measures as accepted by the UK authorities have been accurately and duly put into effect by the Member State.
- (319) The Commission will closely monitor the implementation of the appropriate measures described above and requests the UK authorities to regularly inform it of all steps taken in the implementation process.
- (320) The Commission retains the right to continuously assess the existing aid scheme pursuant to Article 88(1) of the EC Treaty and to propose further appropriate measures required by the progressive development or the functioning of the common market.
- #### 5.3.4. NORTHLINK
- ##### 5.3.4.1. *Definition*
- (a) **NorthLink 1 (2002-2006)**
- (321) As mentioned previously (see Section 5.2.3 above), the aid granted to NorthLink 1 and NorthLink 2 constitutes new aid. Therefore, besides from assessing the current situation, the Commission is also required to assess the compatibility of the measure since the first public service contract was signed with NorthLink 1.
- (322) The relevant provisions for assessing whether the public service tasks of NorthLink 1 were adequately defined are contained in Article 4 of the Maritime Cabotage Regulation, which sets out the specifications that should be part of the definition, namely: ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessels.
- (323) It is fairly clear that the public service contract covering the period 2002-2006 meets this criterion by defining in detail all these parameters. The invitation to tender specified, in particular: the route configuration and minimum number of sailings, the requirement for capacity to carry freight (although not subject to subsidy) and livestock, the minimum capacity requirements (at least equal to those already offered by P&O Ferries) and the initial tariffs, which could not significantly exceed those charged by P&O Ferries.

(324) This public service contract also had a reasonable duration – less than 6 years – in compliance with the Commission's interpretation of the Maritime Cabotage Regulation.

(325) The MoA, which was signed in 2004 following financial difficulties of NorthLink 1 in 2003, basically provided for additional deficit funding and did not significantly change the definition of the public service obligations already in place.

(b) NorthLink 2 (2006-2012)

(326) As indicated already in the decision to open the formal investigation procedure, the Commission considers that the public service tasks entrusted on NorthLink 2 correspond to a legitimate SGEL.

(327) Like the previous public service contract with NorthLink 1, it is clear that the second public service contract with NorthLink 2 also clearly defines all the parameters for the public service obligations in accordance with Article 4 of the Maritime Cabotage Regulation. The invitation to tender specified, in particular: the route configuration and minimum number of sailings, the requirement for ro-ro capacity to carry freight (this time also eligible for subsidy) and livestock, the minimum capacity requirements (at least equal to those already offered by NorthLink 1) and the initial tariffs, which could not significantly exceed those charged by NorthLink 1.

(328) Like the previous contract with NorthLink 1, this public service contract also has a reasonable duration – 6 years – in compliance with the Commission's interpretation of the Maritime Cabotage Regulation.

5.3.4.2. Entrustment

(a) NorthLink 1 (2002-2006)

(329) It seems clear that NorthLink 1 was explicitly entrusted with the provision of the public service in question in the period 2002-2006. The public service contract contained precise indications about the services that NorthLink 1 had to provide and on how the scope of the public service remit might be changed.

(330) The Scottish Executive Transport Group monitored NorthLink 1's performance against the terms of both the original and the revised contracts. NorthLink 1 issued regular performance reports to this body.

(b) NorthLink 2 (2006-2012)

(331) As is the case with NorthLink 1, it is clear that NorthLink 2 was explicitly entrusted with the provision of the

public service in question in the period 2006-2012. The public service contract contains precise indications about the services that NorthLink 2 has to provide and on how the scope of the public service remit may be changed.

(332) The public service contract contains clear provisions on the control of the execution of the public service by imposing regular detailed information from NorthLink 2 to the Scottish authorities about the operation. There are performance indicators which are regularly assessed, for example. If the performance standards are not met, then the grant may be reduced accordingly.

5.3.4.3. Proportionality

(a) NorthLink 1 (2002-2006)

(333) Unlike the subsidies granted to CalMac, which constitute existing aid (see Section 5.2.2 above), the aid granted to NorthLink 1 and NorthLink 2 constitutes new aid. Therefore, it is not sufficient for the Commission to assess whether the provisions of the current public service contract (covering the period 2006-2012) provide sufficient guarantees to avoid over compensation and possible anti-competitive behaviour by the public service provider. It is also necessary to assess whether there has been any over compensation of NorthLink's public service obligations from 2002 onwards and whether the public service provider has engaged in any type of anti-competitive behaviour that would have raised the cost of fulfilling its public service obligations to an extent that would not be proportional to the aim pursued by the public service contracts.

(334) It must however be stressed that the compatibility assessment is limited to checking for over compensation and possible anti-competitive behaviour and does not deal with the question of cost efficient or cost minimisation, unlike the assessment of the existence of State aid under the Altmark 4 condition. In assessing compatibility with Article 86(2) of the Treaty, it is not the Commission's task to check whether the public service could have been delivered more efficiently.

(335) As shown in table 3 above, the net results from the public service activities of NorthLink 1 were positive in some years (2003/2004 and 2005/2006) and negative in other years (2002/2003 and 2004/2005). The overall result from the public service activities of NorthLink 1 during the period in which it operated in the northern islands routes (2002-2006) was positive in the amount of GBP 0,9 million. This amount corresponds to an annual average excess public funding of GBP 0,2 million.

- (336) It must first be noted that the data provided by the UK authorities result from an analytical accounting exercise on the basis of the statutory accounts. These results have been validated by an independent external auditor with regard to the methodology used, the accounting details and the statement content. No significant differences were found between the amounts reported and the underlying books and records of NorthLink 1. This data has been adequately established and is credible ⁽⁵⁶⁾.
- (337) The annual average excess public funding of GBP 0,2 million is very limited when compared with the average annual public compensation granted to NorthLink 1 – approximately GBP 23,2 million ⁽⁵⁷⁾, representing only around 0,9 % of this amount.
- (338) The Commission accepts the principle that the compensation paid to undertakings entrusted with a SGEI 'may not exceed what is necessary to cover the costs incurred in discharging the public service obligations, taking into account the relevant receipts and reasonable profit for discharging those obligations' ⁽⁵⁸⁾. Reasonable profit is defined as '... a rate of return on own capital that takes account of the risk, or absence of risk, incurred by the undertaking by virtue of the intervention by the Member State ...'. In the present case, the average annual profit margin of around 0,6 % of public service revenues ⁽⁵⁹⁾ is very limited and can be accepted as reasonable in view of the risks incurred by NorthLink 1 in discharging its public service obligations. It must in particular be noted that these very limited profits of NorthLink 1 followed a competitive bidding procedure for the public service contract and thus had to be kept to the minimum according to market conditions.
- (339) Therefore, NorthLink 1 has not been unduly over-compensated for the performance of its public service tasks during the period in which it operated the northern islands routes.
- (340) In Streamline Shipping's original complaint of July 2004, it was alleged that at least GBP 2 million was paid to NorthLink 1 outside the scope of the reimbursable expenses regarding its public service obligations directly for chartering a freight vessel. However, as shown above this did not lead to an overcompensation of NorthLink 1's public service obligations.
- (341) As regards possible anti-competitive behaviour, the price data submitted by Streamline Shipping ⁽⁶⁰⁾ does not indicate significant price differences for freight transport between NorthLink 1 and Streamline Shipping. In the Shetland route NorthLink 1's prices are higher than Streamline Shipping's prices in all years. In the Orkney route NorthLink 1's prices are lower than Streamline Shipping's prices in all years (between 5 % and 13 %), but this fact alone does not prove an anti-competitive behaviour. Moreover, the comparison is possibly misled since ro-ro and lo-lo freight rates are not directly comparable as mentioned by the UK authorities.
- (342) Moreover, the Commission notes that the commercial activities carried out by NorthLink 1 were profitable on a stand-alone basis in every year of NorthLink 1's operation. This means that the prices charged by NorthLink 1 on its commercial activities were market driven and compatible with the profit-maximising behaviour of a market investor.
- (343) Furthermore, in its report of December 2005, which analyses the performance of NorthLink 1, Audit Scotland does not mention any possible anti-competitive behaviour (e.g. price undercutting) as a reason for NorthLink 1's financial difficulties. Rather, these difficulties are attributed essentially to increased and unexpected competition from other undertakings.
- (344) In conclusion, NorthLink 1 was not unduly over-compensated for the performance of its public service obligations and there is no evidence that it engaged in any form of anti-competitive behaviour during the period in which it operated in the northern islands routes. It is concluded that the State aid granted to NorthLink 1 was proportional in view of its public service obligations.

(b) NorthLink 2 (2006-2012)

- (345) As regards the NorthLink 2 public service contract, the Commission is required to check, on the one hand, whether there has been any overcompensation of the public service obligations so far. It will also check if there has been any possible anti-competitive behaviour that would have raised the cost of fulfilling the public service obligations to an extent that would not be proportional to the aim pursued by the public service contract. On the other hand, the Commission must check whether the current provisions of the public service contract with NorthLink 2 contain sufficient safeguards to ensure the proportionality of the aid.
- (346) As shown in table 5, the net results from the public service activities of NorthLink 2 were positive in the two first years of operation (2006/2007 and 2007/2008). The overall net result of the operations of NorthLink 2 so far is positive in the amount of GBP 2,4 million. This amount corresponds to an annual average excess public funding of GBP 1,2 million.

⁽⁵⁶⁾ With regard to the admissibility of a 'backward projection' method, see judgement of the Court of First Instance of 7 June 2006 in case T-613/97, *UFEX and Others v Commission* (especially points 128-147).

⁽⁵⁷⁾ A total of GBP 92,6 million was granted to NorthLink 1 during the approximately 4 years of operation.

⁽⁵⁸⁾ See paragraph 14 of the SGEI Framework.

⁽⁵⁹⁾ The average annual revenues from the public service activities of NorthLink 1 amounted to GBP 32,4 million (see table 3 above).

⁽⁶⁰⁾ See table 6.

- (347) As mentioned above in the case of NorthLink 1, it must first be noted that the data provided by the UK authorities result from an analytical accounting exercise on the basis of the statutory accounts. These results have been validated by an independent external auditor with regard to the methodology used, the accounting details and the statement content. No significant differences were found between the amounts reported and the underlying books and records of NorthLink 2. The Commission considers that this data has been adequately established and is credible ⁽⁶¹⁾.
- (348) The annual average excess public funding of GBP 1,2 million is limited when compared with the average annual public compensation granted to NorthLink 2 – GBP 26,6 million ⁽⁶²⁾, representing only around 4,5 % of this amount.
- (349) As mentioned above, the Commission has accepted the principle of a reasonable profit for discharging public service obligations. In the present case, the average annual profit margin of around 2,4 % of public service revenues ⁽⁶³⁾ is limited and can be accepted as reasonable in view of the risks incurred by NorthLink 2 in discharging its public service obligations. It must in particular be noted that these limited profits of NorthLink 2 followed a competitive bidding procedure for the public service contract and thus had to be kept to the minimum according to market conditions.
- (350) Therefore, the Commission considers that NorthLink 2 has not been unduly over-compensated for the performance of its public service tasks during the period in which it has been operating the northern islands routes so far.
- (351) As regards possible anti-competitive behaviour by NorthLink 2, Streamline Shipping argued that the freight rate cuts of 25 % to Shetland and 19 % to Orkney announced at the beginning of the third public service contract in July 2006 were unduly penalising Streamline Shipping and were only possible thanks to the increased subsidy for NorthLink 2 when compared to NorthLink 1.
- (352) As mentioned above, NorthLink 2 does not carry out activities outside the scope of the public service contract. In particular, unlike the public service contract with NorthLink 1, the contract between the Scottish authorities and NorthLink 2 covered freight transport as a public service activity. This reduction in the freight rates was imposed by the Scottish authorities as part of the terms of the tender. Thus, this information was public and bidders had to take it into account when formulating their bids.
- (353) NorthLink 2 has so far not been over-compensated for its public service obligations. Moreover, as shown in table 5 above, freight transport has been profitable on a stand-alone basis in the 2 years of NorthLink 2's operation. This means that the prices charged by NorthLink 2 on its commercial activities have been market driven and compatible with the profit-maximising behaviour of a market investor.
- (354) Additionally, the Commission recognises that ro-ro and lo-lo freight rates may not be directly comparable for the reasons set out in recital 100 above.
- (355) Moreover, unlike NorthLink 2, Pentland Ferries does not publish its freight tariffs and rather invites potential customers to contact its booking offices to obtain a quote and make a booking. Therefore, it would be difficult for NorthLink 2 to deliberately and consistently undercut Pentland Ferries' tariffs.
- (356) Also related to possible anti-competitive behaviour by NorthLink 2, Pentland Ferries argued that NorthLink 2 has been practicing a discount scheme for Orkney residents called 'friends and family' that is having a detrimental effect on the competing service provided by Pentland Ferries ⁽⁶⁴⁾.
- (357) As shown above in table 7, all the basic tariffs charged by NorthLink 2 for passengers and vehicles are higher than those charged by Pentland Ferries. There is no public evidence on possible discounts practiced by Pentland Ferries, but even assuming that it does not offer any discounts, the tariffs charged by NorthLink 2 including the 'friends and family' discount scheme are not significantly or consistently lower than the tariffs charged by Pentland Ferries. Moreover, the discounts are not available during the busy peak season (July and August). Furthermore, as indicated by the UK authorities, the discount scheme accounts for a very small proportion of NorthLink 2's carryings (1,6 %) and to an even smaller proportion of NorthLink 2's revenues (0,5 %). The foregone revenue to NorthLink 2 on ticket sales as a consequence of the discounts (ignoring the possible additional demand generated by the discounts) is very limited ⁽⁶⁵⁾. Finally, Pentland Ferries was unable to prove with concrete figures that it has been financially hit by this discount scheme. Consequently, the Commission considers that there are no solid grounds for alleging anti-competitive behaviour by NorthLink 2 or any serious affectation of competition on account of this discount scheme.

⁽⁶¹⁾ See footnote 56.

⁽⁶²⁾ See table 4.

⁽⁶³⁾ The average annual revenues from the public service activities of NorthLink 2 amounted to GBP 50,5 million (see table 5 above).

⁽⁶⁴⁾ See recitals 107 to 109.

⁽⁶⁵⁾ Based on the UK authorities estimation of the total revenue from this scheme (for all eligible passengers and cars) in 2008 - around GBP 95 000 - the discount of 30 % would represent around GBP 40 700.

- (358) Moreover, it was argued by an interested party that NorthLink 2 is offering Bed & Breakfast accommodation in Orkney (when the ship is static overnight) as a commercial activity at rates which are below cost and that this is affecting hotel-based Bed & Breakfast providers⁽⁶⁶⁾. Although this issue was not raised in the decision to open the formal investigation procedure, no concrete evidence was provided showing that the prices charged by NorthLink 2 for this service are below cost or that this service is negatively affecting revenues of competing hotel-based Bed & Breakfast operators. In addition, boat accommodation prices and the costs of providing such accommodation cannot be directly compared with hotel-based accommodation prices and the respective costs. Consequently, the Commission considers that there are no solid grounds for alleging anti-competitive behaviour by NorthLink 2 or any serious distortion of competition on account of this service. In any case, any possible distortion of competition would not affect trade between Member States given that it entirely takes place within Orkney.
- (359) Besides from assessing the proportionality of the aid in the past, the Commission must also check whether the provisions of the public service contract offer sufficient guarantees that there will be no overcompensation or anti-competitive behaviour in the future.
- (360) As mentioned above⁽⁶⁷⁾, the public tender was carried out in an open and transparent way.
- (361) In the Commission's view, the provisions of the public service contract are appropriate to prevent overcompensation for the performance of the public service obligations. Compensation is limited to operating costs (including reasonable profit) minus operating revenues. The costs which are eligible for compensation are also clearly defined in the public service contract.
- (362) There is a claw back mechanism that will return the major part of any potential excess compensation to the Scottish authorities. Only a small amount is not returned. For example, if overcompensation is GBP 1 million, only GBP 275 000 will be kept by NorthLink 2. In case overcompensation is GBP 10 million, only GBP 725 000 will be kept by NorthLink 2. This system is intended to create an incentive for NorthLink 2 to reduce costs and be more efficient. These amounts are very limited and in accordance with the definition of 'reasonable profit' laid down in the SGEI Framework (point 18 thereof)⁽⁶⁸⁾. Although the SGEI Framework does not apply in the present case, the Commission considers that the potential excess compensation amounts that may be retained by NorthLink 2 are very limited and proportional with regard to the compensation amounts.
- (363) Furthermore, the profit margin foreseen in the public service contract results from a competitive bidding procedure and so it is ensured that this margin is set at a reasonable level.
- (364) There is also a clause in the public service contract which ensures that, in case the public service provider receives further public support from other sources, the grant will be reduced accordingly.
- (365) In conclusion, the public service contract contains sufficient safeguards against overcompensation for the performance of the public service obligations.
- (366) Besides the issue of overcompensation, it must also be assessed whether the public service contract contains sufficient safeguards to avoid anti-competitive behaviour by NorthLink 2 that might cause undue distortions of competition. This would be the case, for example, if NorthLink 2 were in a position to consistently undercut competitors' prices, thereby driving them away from the market.
- (367) The public service contract sets strict conditions on the pricing of the tickets. It imposes consultation of the Scottish authorities where prices are reviewed. In particular, NorthLink 2 would infringe the provisions of the public service contract if it were to unilaterally and unjustifiably reduce prices to drive existing competitors out of the market or to foreclose the entry of potential competitors. Moreover, no additional compensation can be claimed by NorthLink 2 for any reduction in revenue arising from discounts or reductions in the prices established in the published tariff schedule. This also prevents possible anti-competitive price behaviour.
- (368) Another possibility of distorting the market would be if the public service provider could, on its own will, significantly modify or increase its public service offer, for example by adding new routes or significantly increasing frequencies. If NorthLink 2 would automatically be eligible for further compensation for these added services, this might cause an unwarranted distortion of competition beyond what can reasonably be accepted as counterpart for the fulfilment of the public service obligations.

⁽⁶⁶⁾ See recital 111 above.

⁽⁶⁷⁾ See section assessing compliance with Altmark condition 4 (recitals 220-224).

⁽⁶⁸⁾ For comparison, if overcompensation were to total GBP 10 million (a very unlikely and unprecedented scenario), the GBP 725 000 that NorthLink 2 would retain represents only around 2,5 % of the annual compensation paid to NorthLink 2 in 2007/2008 and a much lower proportion of total revenues.

- (369) The public service contract explicitly provides for prior consultation and approval by the Scottish Ministers before any major adjustments are made to the published timetables and frequencies or to the agreed services.
- (370) There are also specific provisions in the public service contract which prohibit the Operator from cross-subsidising between its public service and non-public service activities and requiring all transactions between NorthLink 2 and its subsidiaries to be carried out on an arms length basis.
- (371) Almost all of NorthLink 2's activities fall under the scope of the public service contract. Nevertheless, in order to ensure transparency, there must be separation of accounts between its public service activities and its potential non-public service or commercial activities in compliance with the provisions of the Transparency Directive.
- (372) Under the terms of the public service contract, NorthLink 2 must report, on a yearly basis, on the actual costs incurred with the provision of the public service tasks. This 'Actual Outcome Statement' isolates the public service costs from the rest of NorthLink 2's activities. Therefore, it is ensured that the amount of public funds allocated to NorthLink 2 and the use of those funds are clearly distinguished from the remainder of NorthLink 2's activities. The public service contract provides explicitly for the need to keep clear, separate and transparent accounting systems for the financing and operating of the public service activities.
- (373) In order to ensure that the costs incurred with the public service activities are clearly distinguished from the costs incurred with other activities, it is also necessary to put in place an appropriate system for allocating costs which are common to both types of activities.
- (374) The public service contract contains in detail all the costs that are admissible for compensation. Besides from the deficit grant, which is intended to cover all the operating costs associated with the operation of the public service (e.g. seagoing personnel costs, fuel, terminal traffic dues, ticketing, insurance, etc.), supplements are foreseen for unexpected fuel cost rises and for capital expenditures linked to the acquisition of assets for the provision of the agreed services. All the costs covered by the deficit grant are precisely quantified in the Base Case scenario and the conditions for applying and for determining the potential fuel supplements and capital supplements are precisely defined in the public service contract.
- (375) Therefore, the public service contract is sufficiently clear as regards the allocation of costs between public service and non-public service activities.

- (376) The Commission positively notes in this context that the UK authorities intend to publicly consult interested parties whenever substantial changes are introduced in the public service obligations of NorthLink 2 for the northern islands routes. They will also require NorthLink 2 to produce separate audited profit and loss accounts for public service activities and for commercial activities starting in the 2009/2010 financial year and intend to include such requirements in all future public service contracts for ferry services in the northern islands.

5.3.4.4. Conclusion

(a) NorthLink 1 (2002-2006)

- (377) The public service obligations imposed on NorthLink 1 have been correctly defined and adequately entrusted. The State aid granted to NorthLink 1 during the period 2002-2006 has not overcompensated the company for the provision of the public service tasks it was entrusted with. There is also no sufficient evidence of anti-competitive behaviour that would have artificially raised the public service costs, thereby causing an undue distortion of competition.
- (378) Therefore, the State aid granted to NorthLink 1 during the period 2002-2006 is compatible with Article 86(2) of the Treaty.

(b) NorthLink 2 (2006-2012)

- (379) The State aid granted to NorthLink 2 so far has not overcompensated the company for the provision of the public service tasks it was entrusted with. There is also no sufficient evidence of anti-competitive behaviour that would have artificially raised the public service costs, thereby causing an undue distortion of competition.
- (380) The SGEI for the operation of the northern islands routes is well defined and has been duly entrusted to NorthLink 2. There are sufficient safeguards to ensure that the compensation granted to NorthLink 2 is proportional to its public service obligations. Thus, the State aid granted to NorthLink 2 for the operation of those routes is compatible with Article 86(2) of the EC Treaty.

6. CONCLUSION

- (381) On the basis of the foregoing it is concluded that the State aid provided to CalMac for the operation of all western islands routes, with the exception of Gourock-Dunoon, is an existing aid which is compatible with Article 86(2) of the Treaty.

(382) As regards the Gourock-Dunoon route, in accordance with Article 19 of the Procedural Regulation, the Commission records the acceptance, by the UK authorities, of the appropriate measures proposed by it in accordance with Article 18 of the Procedural Regulation and considers that, subject to the correct implementation of the appropriate measures described above, the existing aid measure will also be compatible with Article 86(2) of the Treaty. The United Kingdom is required to initiate the procedures required for launching a public tender for this route before the end of 2009. The subsequent public service contract should start before end-June 2011. The implementation of the appropriate measures described above will be closely monitored by the Commission and the United Kingdom is requested to regularly inform it of all steps taken in the implementation process.

(383) The Commission considers that the State aid granted to NorthLink 1 and NorthLink 2 for the operation of the northern islands routes in 2002-2006 and 2007-2009 respectively is compatible with Article 86(2) of the Treaty.

HAS ADOPTED THIS DECISION:

Article 1

The existing State aid granted to CalMac Ferries Ltd under the public service contract for the provision of ferry services in the Scottish western islands (excluding the Gourock-Dunoon route) is compatible with Article 86(2) of the Treaty.

Article 2

The existing State aid granted to Cowal Ferries Ltd with regard to the operation of the Gourock-Dunoon route is compatible

with Article 86(2) of the Treaty, subject to the acceptance, by the United Kingdom, to implement the appropriate measures in accordance with Article 19 of Regulation (EC) No 659/1999.

In particular, the United Kingdom shall initiate the procedures required for launching a public tender for the Gourock-Dunoon route before 31 December 2009. The subsequent public service contract must commence before 30 June 2011.

Article 3

The United Kingdom shall promptly inform the Commission about the steps taken to implement its commitments with regard to the financing of the Gourock-Dunoon route.

Article 4

The State aid granted to NorthLink Orkney and Shetland Ferries Ltd and to NorthLink Ferries Ltd under the respective public service contracts for the provision of ferry services in the Scottish northern islands is compatible with Article 86(2) of the Treaty.

Article 5

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 28 October 2009.

For the Commission

Antonio TAJANI
Vice-President

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