

REPORT BY MEMBER STATES UNDER ARTICLE 9 OF THE SGEI DECISION AND POINT 62 OF THE SGEI FRAMEWORK WITH REGARD TO PUBLIC SERVICE OBLIGATIONS IN SPAIN

01 June 2014

1. INTRODUCTION

On **25 February 2013**, the **European Commission Director General for Competition** sent a letter asking Spain to provide **information on state aid** in the form of public service compensation granted to some companies involved in managing **Services of General Economic Interest (SIEG)**. Under the terms of Decision 2012/21/EU and the Communication "EU framework for state aid in the form of public service compensation" published on 11 January 2012, this information must be sent **before 30 June 2014**.

On 10 April 2014, the European Commission Director General for Competition sent a second letter to remind Spain of the obligation to send the information before the required date.

This information was requested by the Secretary of State for the European Union belonging to the Ministry of Foreign Affairs and Cooperation from the Directorate General for Civil Aviation (DGAC) among other public bodies.

As the **body responsible for managing Public Service Obligations** with regard to air transport declared in Spain, the **Subdirector General for Air Transport** of the DGAC drew up the following report with regard to compliance with Decision 2012/21/EU and the SGEI Framework.

2. PUBLIC SERVICE OBLIGATIONS IN SPAIN

One of the main tools used by the various governments (in Spain as well as throughout the European Union) in order to guarantee the connectivity of their outlying regions has been the establishment of **Public Service Obligations (PSOs)** over air routes where the application of **general free market rules will not guarantee the adequate mobility of citizens in these regions**.

Over these routes, and as an exception to the general system of freedom of access to the market and price fixing, governments set conditions on maximum prices, number of flights, timetables, type of aircraft to be used, etc., to be complied with by operating companies, **in accordance at all times with the provisions of Regulation 1008/2008**, of the European Parliament and of the Council of 24 September on common rules for the operation of air services in the Community.

In Spain there are currently **18 domestic air routes declared as public service obligations** (13 for inter-Canary Island links, 3 for inter-Balearic island links, one on the Minorca-Madrid route and another on the Almería-Seville route).

In general, the services offered by **airlines under conditions of free competition have met** or even exceeded the connectivity conditions established in the **PSO obligations** over domestic routes. **This meant that no administrative action** by the state **has been required**.

Despite this, over recent years, the supply of services under a system of free competition has not achieved minimum connectivity levels over some routes, which has meant that in order to achieve the PSO conditions, it has been necessary to award exclusive contracts for the operation of certain links by means of public contract notices, and if these levels of connectivity have not been financially sustainable for the operating airlines, compensations have been established that cover solely the shortfall experienced by the airlines as a consequence of the PSO obligations. These contract notices were published in accordance with the provisions of Article 17 of the said Regulation 1008/2008.

This is the situation that arises for the four air routes between the Canary Islands (Gran Canaria - South Tenerife, Gran Canaria - El Hierro, North Tenerife - La Gomera and Gran Canaria - La Gomera), and on the route that links Minorca and Madrid, and on the Almería - Seville route.

3. APPLICATION OF THE SGEI FRAMEWORK TO THE PUBLIC SERVICE OBLIGATIONS

Article 14 of the Treaty on the Functioning of the European Union (TFEU) states that, without prejudice to Articles 93, 106 and 107 of the Treaty, the Union shall operate within its powers to take care that services of general economic interest operate on the basis of principles and conditions which enable them to fulfil their missions.

In this regard, Article 106(2) states that:

2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly, shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.

The European Union and the Commission in particular, considered that in sectors that each Member State believes should be declared Services of General Interest (as in the case of air transport) that are generally provided in principle under a system of free competition (in other words, Economic Services of General Interest), the administration may establish a set of minimum conditions or levels relating to the service provided by establishing Public Service Obligations.

When the services offered by the service-providing companies, namely the airlines in the case of air transport, do not reach the levels established in the PSOs, EU legislation allows administrative intervention with the aim of guaranteeing these obligations, including financial compensation for entities providing a service when it is not profitable to them, provided they meet requirements laid down in this regard by European legislation.

Furthermore, as we will see, **when this compensation is limited to making up for the shortfall experienced by the company as a consequence of having to comply with the PSO obligations, it need NOT be treated as Public Aid** for the purposes of applying the rules and limitations established in EU legislation.

In this sense, **the fourth recital of Decision 2012/21/EU and points 2 and 3 of the "SGEI Framework" Communication**, establish that, in order for a compensation for public service **NOT to be treated as state aid** under Article 107 of the TFEU , **four cumulative criteria must be complied with (*Altmark criteria*):**

1. First, the recipient undertaking must be actually required to discharge public service obligations, and these obligations must be clearly defined.

PSOs in Spain are stated by means of **Council of Ministers Agreements published in the Official State Bulletin (BOE)**. **These Agreements clearly define the operating conditions that must be met by airlines interested in offering flights on affected routes.** These conditions are imposed solely to the extent necessary to guarantee minimum requirements with regard to prices, flight frequencies and timetables, capacity, ticket prices, continuity and so on, in accordance with the provisions of Article 16.1 of Regulation 1008/2008.

If no company is seen to be interested in operating in accordance with the established conditions, the State proposes to limit access to the affected route to a single airline that will be selected by means of a public contract notice (Article 16.10 and 17 of Regulation 1008/2008), for which the costs incurred in complying with the obligations will be offset (Article 17.8 of Regulation 1008/2008).

The contract notice will be public and transparent and notified to the European Commission by publishing in the Official Journal of the European Union all information relating to service levels, contractual term, rules relating to amendment and finalisation of the contract and penalties in the event of non-compliance, maximum compensation and calculation parameters and so on, as laid down in Article 17.3 of Regulation 1008/2008.

The award of the contract, when the airline in charge of carrying out the obligations will be appointed, will be carried out by administrative contract and will also be published in the BOE and the Official Journal of the European Union.

2. Secondly, the parameters used to calculate the compensation must be established in advance in an objective and transparent manner.

The maximum compensation amount, published in the call for tenders, is established beforehand following objective and transparent criteria, taking into account the cost that an airline would incur due to operating the affected route and the income it would obtain from operating that route, plus a reasonable benefit (net cost).

The airline awarded the contract will be the one that submits the best technical offer at the lowest cost to the Administration. **Criteria for evaluating technical and financial offers will also be established in a transparent manner in the contract specifications.**

3. Thirdly, the compensation must not exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations.

Once the contract has been awarded, the final compensation will be determined a posteriori on the basis of the costs and income that the company has actually incurred. Once a financial year has ended, the airline settles its audited income and costs with the Administration, separately and independently from the other routes operated by the company, and the Administration calculates the final amount to be paid in compensation.

If the airline incurs a shortfall greater than the maximum amount requested in its economic offer, the Administration will only pay compensation up to that maximum quantity, from which it will subtract the corresponding penalties for non-compliance with the contract, if applicable.

4. Lastly, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with the necessary means, would have incurred.

As already stated, the airline responsible for complying with Public Service Obligations is selected by means of a public call for tenders.

For all the above reasons, the Public Service Obligations that are put out to tender in Spain meet the four Altmark criteria for the compensation not to be considered aid under Article 107 of the TFEU.

4. SGEI REPORT

We will now consider point 4 of the requested report, which covers compensation paid to successful tenderers for the exclusive operation of the PSO routes subject to tender (which as stated above should not be considered state aid).

4. MISCELLANEOUS

A. (not compulsory)

If your Member State has not granted state aid for the provision of the SGEI in given sectors, information on other instruments to guarantee the provision of such services could be useful (direct aid to users, compensation complying with the four Altmark criteria, *de minimis* aid and so on). If you wish, provide a short description of these instruments and the areas in which they are used.

As already stated, out of the 18 routes declared to be PSO in Spain, it has only been necessary to limit operation to a single airline in six cases:

- **Inter-Canary Island market:** The airline that was responsible for sole operation of the routes with the lowest demand (Binter Canarias), announced its withdrawal in 2011 due to financial losses incurred in those links.

In order to keep these links operational, during 2012, the Ministry of Public Works put the routes La Gomera-Tenerife North, La Gomera-Gran Canaria, El Hierro- Gran Canaria and Tenerife South-Gran Canaria, out to tender and the contracts were awarded to Naysa for the value of EUR 4.6 million for duration of nearly 2 years of the contract, which terminated on 31 July 2014.

In order to ensure the continuity of flights on these routes, we are currently in the process of putting their operation out for tender again, under exclusive contract. The deadline for submitting offers was 26 April this year and in the coming days we will open and evaluate the offers received. We estimate that the tendering procedure will be completed before 1 August.

- **Balearic island market:** When the airline Spanair ceased trading at the beginning of 2012, the Minorcan Islanders lost a direct connection that was essential for the island, the Minorca-Madrid link, which is only attractive for airlines to operate during the summer months.

In order to ensure connectivity between Minorca and Madrid during the winter season, the Ministry of Public Works put the Minorca-Madrid route out to tender for an exclusive contract during the months of low demand, from October to May. This contract was awarded to the airline Air Nostrum, for the sum of approximately EUR 1.5 million, for two periods, each lasting eight months.

During the months when this route was operated under PSO conditions, from the beginning of operations on 1 March 2013, we have noted a significant and unpredictable drop in the number of passengers, which has meant that Air Nostrum has accrued operating losses that are much higher than initially envisaged. Due to the impossibility of providing an economically sustainable operation, the company was forced to notify the Ministry of Public Works of its intention to cease trading as of 29 March 2014.

Taking the above into account, on 21 February 2014, the Secretary of State for Infrastructure, Transport and Housing decided to terminate the contract by mutual agreement, with effect as of 29 March. As part of the decision-making process, Air Nostrum undertook to carry on providing services, within an open market framework, until the end of the first PSO period, from 30 March to 31 May 2014. This interim operation will be carried out in accordance with the public service obligations of the Council of Ministers Agreement applicable at all times, without receiving any financial compensation.

Furthermore, an analysis of the market situation showed that the terms of the Council of Ministers Agreement of 2012 did not effectively meet the actual market situation and needs, and they therefore needed to be reviewed.

This was the gist of a statement by the Joint Ministerial Commission of Public Works - Govern de Les illes Balears, a forum for monitoring public service obligations established for these routes, in its meeting of 26 November 2013. At this meeting, a need was recognised to restructure the current conditions of the PSO in order to better adapt them to the needs of the island, adjusting frequencies to actual demand and

improving timetables in order to promote better connectivity with domestic and international flights departing from the Madrid hub.

Accordingly, on 21 February 2014, the Council of Ministers agreed to new operating conditions on this route. In accordance with the provisions of EU Regulation 1008/2008, these new conditions were published in the OJEU by means of an informative note dated 5 March, as well as in the Spanish Official State Bulletin of 14 March.

Given that no airline has shown any interest in operating this route without receiving financial compensation, we are carrying out the necessary actions to put it out to tender, to ensure that the process is terminated before 1 October in order to ensure the continuity of operations.

- Mainland market: In 2009, public service obligations were established for the Almería-Seville route by means of a Council of Ministers Agreement of 13 March 2009. The Andalusian government requested a declaration of public service obligations for that route in order to guarantee a minimum provision of scheduled services, with the aim of strengthening local cohesion within the Autonomous Community, improving communication between both cities and optimising the effects of population development and the economic dynamism of the province of Almería. The public service obligations would temporarily cover a demand for transport services that is under-served at present by other methods, and they would be applied under a scheme of cooperation between Central Government and the Autonomous Community under a Collaboration Agreement signed for this purpose.

Operation of this route was also put out to tender for a sum of EUR 11.9 million for a period of four years. The contract was awarded to the airline Air Nostrum for EUR 10.5 million. Operations began on 15 January 2010 and ended on 14 January 2014.

With the aim of guaranteeing service continuity in coming years, the Andalusian government requested the renewal of the public service obligations. The technical conditions of the PSO renewal were reviewed, given that experience built up over the past four years revealed a need to adjust operating parameters to actual demand requirements more effectively.

In accordance with the Andalusian government's request, the PSO conditions were changed on 27 December 2013, by means of Ministerial Order FOM/2457/2013. Furthermore, on 24 February 2014, the Collaboration Agreement between central government and the Andalusian government was renewed, and under the terms of this the Andalusian government again assumed all responsibility for the economic content.

Once the operating conditions had been changed and the Agreement signed, and given that no airline showed any interest in operating this route sustainably without receiving financial compensation, we put the operation out for tender under an exclusive contract. The term for the submission of offers opened on 20 March, and ended on 20 May this year.

In the coming days, the technical offers received will be opened and evaluated and the contract will be awarded to the most advantageous offer. **We estimate that the tendering procedure will be completed on 31 July.**

At the beginning of the year, the airline Air Europa announced its intention to operate the route under a free market system, even though it warned that in any case a call for tenders would be necessary because market conditions meant that the operation would not be financially sustainable.

This company is currently operating under an open market system.

All information on routes subject to Public Service Obligations, and in particular to these six routes put out to tender, is available to the European Commission through the Directorate General for Mobility and Transport (DG MOVE).