II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 6 July 1994

concerning compensation in respect of the deficit incurred by TAP on the routes to the Autonomous Regions of the Azores and Madeira

(Only the Portuguese text is authentic)

(Text with EEA relevance)

(94/666/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 93 (2) thereof,

Having given notice in accordance with the above Article to interested parties to submit their comments and having regard to those comments,

Whereas :

I

By letter of 10 April 1992, registered on 13 April 1992, the Portuguese Government informed the Commission of its intention to settle an alleged accumulated debt of Esc 35 140 964 000 owed to Transportes Aéros Portugueses SA (hereinafter referred to as 'TAP').

By letter of 25 June 1992, registered on 26 June 1992, in response to a letter from the Commission of 28 May 1992, the Portuguese authorities provided information on the abovementioned operation and listed the criteria which should apply for compensating TAP's losses on the routes to the Autonomous Regions of the Azores and Madeira (hereinafter referred to as 'the Autonomous Regions') from 1992 onwards.

The Commission requested further information by letters of 4 August and 16 December 1992, which the Portuguese Government answered by letters of 28 October 1992 and 15 January 1993, registered on 30 October 1992 and 25 January 1993 respectively.

On 11 January 1993 officials of the Commission's Directorate-General for Transport responsible for State aid held a meeting in Brussels with representatives of the Portuguese Civil Aviation Administration, TAP and the Portuguese Permanent Representation.

In March 1993 the Commission decided that the compensation in respect of the deficit incurred by TAP in the 1978-91 period was aid compatible with the common market pursuant to Article 92 (3) (a) of the Treaty, but opened the procedure with regard to future method for calculating compensation (hereinafter referred to as 'the new method'). The Portuguese Government was informed of this decision by letter of 14 April 1993, which was published in the *Official Journal of the European Communities*(1), giving interested third parties the opportunity to comment.

The Portuguese authorities replied to the Commission's letter by letter of 13 July 1993.

The United Kingdom commented on the case, supporting the Commission's conclusions. These comments were transmitted to the Portuguese authorities which replied by

(1) OJ No C 178, 30. 6. 1993, p. 2.

letter of 23 September 1993. Further information was provided by the Portuguese authorities by letters of 16 February and 18 May 1994, in reply to a Commission's letter of 24 November 1993.

II

Article 93 (3) of the Treaty provides, *inter alia*, that where the Commission opens the Article 93 (2) procedure with regard to notified aid the Member State concerned shall not put the proposed measure into effect until this procedure has resulted in a final decision. The Portuguese Government informed the Commission that, as regards the deficit incurred in respect of the Autonomous Regions in 1992, it made a payment of Esc 5 230 671 000 in favour of TAP in March 1993. The Portuguese Government, by having made this payment without waiting for a final decision from the Commission, has failed to fulfil its obligations under Article 93 (3) of the Treaty.

III

The Portuguese authorities provided an analytical breakdown of the deficit incurred by TAP on each of the routes in question, indicating the costs incurred and the revenues earned. In addition, the Portuguese authorities maintained that :

1. compensation in respect of the deficit for public service obligations imposed by the State on an airline cannot be considered as State aid under Article 92 of the Treaty and in particular not as aid which distorts competition and favours the airline in question. The fares imposed have been established only according to the level of the disposable income of the populations of the Autonomous Regions. Consequently, the Portuquese Government could not impose such obligations on an airline without assuming some of the burdens. Such an arrangement could be said to be of a semi-contractual nature and cannot be considered as State aid ;

2. contrary to what was stated in the opening of the procedure, TAP cannot freely fix its normal fares on the routes in question. In fact according to Article 1 of the Portuguese Decree No 1057/91 of 18 October 1991 :

   'The fares for schelduled flights on domestic routes between the mainland and the Autonomous Regions of the Azores and Madeira, and between these regions, shall be set on the basis of the following criteria :

   (a) for each of the areas referred to, a given average weighted fare may not exceed 80 % of the average RPK in the European network of the carrier operating that route, both those averages adjusted in relation to the distance, according to internationally recognized criteria'.

   The fact that the average fare in the European network, where there is fierce price competition, is used as a basis obviates any discrimination in fare-setting on exclusive routes. Furthermore, the reference value of 80 % is based on a comparison of respective costs per destination/kilometre and is thus directly related to the costs borne by the airline on the routes for which compensation is provided. In practice the normal fares applied by TAP for the Autonomous Regions is considerably lower than 80 % of the normal fares on the European network for routes of similar distances.

   This is borne out by the fact that in 1992 TAP's operating deficit for the Autonomous Regions was Esc 5 369 508 000 and the compensation based on the criteria used by the Portuguese Government was only Esc 5 230 671 000.

IV

Article 231 of the Portuguese Constitution provides that social protection of the residents of the Autonomous Regions is an imperative commitment for the Portuguese Government, which must smooth out the inequalities stemming from their geographical position.

The Portuguese authorities have imposed public service obligations on the routes between the Autonomous Regions and the mainland, and has entrusted TAP with the task of operating such routes. For this purpose the Government has fixed, on a yearly basis, the tariffs for the residents of the Autonomous Regions at levels considerably lower than those an airline would fix taking into account its costs. Consequently TAP suffers considerable losses in fulfilling the public service obligation requirements imposed by the Portuguese Government.

The Portuguese Government compensates TAP in respect of the deficit incurred on these routes. Since 1992 the Portuguese Government has been applying the following criteria to calculate the compensation :

(a) TAP will receive an annual subsidy in respect of the regular air links between the mainland and the Autonomous Regions, between the Autonomous Regions and between Funchal and Porto Santo. The subsidy will be calculated by the Inspectorate-General for Finance and made available in monthly instalments, equivalent to number of residents, students and persons accompanying the Autonomous Regions' sporting teams actually carried to the mainland, multiplied by the difference between the normal tariff which TAP applies to other passangers and the tariffs which were set for the abovementioned passengers on those routes in accordance with Portuguese law (Article 2 of Decree-Law 311/91 of 17 August 1991) ;

(b) moreover, the State may compensate TAP each year for the loss which the Inspectorate-General for Finance recognizes the company as having actually suffered on the routes served for non-commercial reasons (i.e. routes served for political reasons which an airline would not operate if it only took into account its commercial interests) determined by the Government. However, the Portuguese authorities have confirmed to the Commission that no such routes have been designated, other than the routes to the Autonomous Regions.

The Portuguese authorities have alleged that the direct flights to the Autonomous Regions carry only around 90 % of the Regions' traffic, since the remaining 10 % of the passengers use international flights which serve the Regions. If all the traffic used only direct flights, TAP would have to increase the number of such flights by the same proportion as the increase in traffic, since the load factor is already very high (75,8 % in 1990). These additional flights would lead to the same deficit as the direct flights, having the same load factor and the same deficit per passenger carried. For the Portuguese authorities this means that the deficit caused by passengers travelling only on the domestic leg (to and from the Autonomous Regions) of an international flight (e.g. Funchal — Lisbon — Rome) should also be taken into account in calculating the total deficit incurred by TAP.

On the basis of this assumption, the Portuguese Government has calculated this additional deficit by multiplying the number of passengers travelling on the national leg of these flights by the deficit for each passenger on the direct flight for the same route.

In the course of the Article 93 (2) procedure the Portuguese authorities showed that they have imposed a ceiling corresponding to 80 % of the average fare charged by TAP for European flights of similar distance. This limitation to TAP's tariff freedom should, in principle, preclude the possibility for the new method to involve over-compensation of the deficit actually incurred. The tariffs set by TAP for the European routes reflect its costs and the flights to the Autonomous Regions and European flights of similar distance should, in terms of fixed costs, have a similar cost structure (variable costs, such as landing charges, ground handling and maintenance fees should be lower for the flights from the mainland to the Autonomous Regions, which are domestic flights, than for the European ones). Therefore, the 80 % tariff ceiling should prevent TAP from setting its normal fares at a level higher than its costs. In this respect the Portuguese authorities have shown in detail that in 1992 and 1993 TAP's operating deficit for the routes to the Autonomous Regions was Esc 5 369 508 000 and 5 005 831 000, and that compensation based on the new method was Esc 5 230 671 000 and 4 909 545 000, respectively.

According to Council Regulation (EEC) No 2408/92 [1] on market access, a public service obligation is any obligation imposed upon an air carrier to take, in respect of any route which it is licensed to operate by a Member State, all necessary measures to ensure the provision of a service satisfying fixed standards of continuity, regularity, capacity and pricing, which standards the air carrier would not assume if it were solely considering its commercial interest.

V

Article 92 (1) of the Treaty and Article 61 (1) of the EEA Agreement (hereinafter referred to as the Agreement) provide that any aid granted by a State or through State resources which distorts or threatens to distort competition shall, in so far as it affects trade, be incompatible with the common market and the Agreement.

In the present case the Commission has opened the Article 93 (2) procedure with regard to the new method chosen by the Portuguese Government because this method is not based on the deficit actually incurred by the airline, but on the difference between the tariff imposed by the Government and the normal tariff that TAP applies to the other passengers. The Commission considered that TAP could set the normal tariff at a very high level and thus make high profits because of the compensation, given the fact that most of the Regions' traffic is for the special category of passengers who benefit from promotional tariffs.

In the present case the Portuguese Government has an interest in maintaining adequate air services to the Autonomous Regions to promote their development and resolve some of the problems stemming from their geographical isolation. The Portuguese Government has, to this end, imposed tariff obligations with regard to these routes. It has directly entrusted the 'flag carrier' TAP with the operation of these routes and has decided to compensate the losses incurred as a result of the public service requirements. In order to minimize the costs of the service the Portuguese Government could have followed a public tender procedure and thus offered any European carrier the possibility of submitting a tender offer. The right to operate those routes could then have been awarded to the best tenderer, taking into account, *inter alia*, the cost of the compensation required. However, because Article 5 of Regulation (EEC) No 2408/92 guarantees, until the end of 1995, the exclusive concession of TAP for Madeira and because Regulation (EEC)

[1] OJ No L 240, 24. 8. 1992, p. 8.

No 2408/92 is not applicable to the Azores, the Portuguese Government is not obliged to apply the tender procedure provided for in Article 4 thereof to the traffic to the Autonomous Regions. In this context it should be noted, however, that the Portuguese Government committed itself to apply Article 4 to these Autonomous Regions as of 1 January 1996 at the latest.

In the light of the above, the Commission cannot share the Portuguese Government's opinion on the 'semi-contractual' nature of the arrangement with TAP. The tariff obligation imposed on TAP appears to be comparable to a legal requirement unilaterally established by the State and cannot be considered as a contractual obligation freely negotiated by two parties. The Portuguese Government did not follow an open-tender procedure for the selection of a carrier to operate the routes in question; consequently, it cannot be excluded that the amount of State resources actually paid to TAP might be higher than the amount payable after the award of a tender. Compensation in respect of public service obligations is considered by the Commission to constitute State aid within the meaning of Article 92 (1) of the Treaty (see Memorandum No 2 of 15 March 1984 on the development of Community air transport policy — COM(84) 72 final). Accordingly, the compensation has the character of an aid in favour of TAP.

The aid, by strengthening TAP's competitive position with regard to its competitors, distorts competition within the EEA, which, after the entry into force of the liberalization measures, is a market characterized by accrued competition. The aid affects trade because air transport is an industrial activity which by its nature involves trans-border operations.

The aid to TAP cannot be considered compatible with the common market pursuant to Article 92 (2) (a) of the Treaty and Article 61 (2) (a) of the Agreement. Under those provisions, which have not been invoked by the Portuguese authorities, aid of a social character granted to individual consumers is compatible with the common market, in so far as it is granted without discrimination related to the origin of the products. These Articles are not, however, applicable to the present case. Compensation for the deficit incurred by restricting access to the routes to the Autonomous Regions to TAP appears to be an aid measure on behalf of the carrier.

The aid under scrutiny is not an aid to promote the execution of an important project of common interest or to remedy a serious disturbance in the economy of a Member State pursuant to Article 92 (3) (b) of the Treaty and Article 61 (3) (b) of the Agreement.

The compensation of TAP's operating deficit does not represent a sectoral aid falling within Article 92 (3) (c) of the Treaty or Article 61 (3) (c) of the Agreement, because it is not aimed at assisting the air transport sector or overcoming any handicaps of the Portuguese airline.

Article 92 (3) (a) and (c) of the Treaty and Article 61 (3) (a) and (c) of the Agreement provide for exemption in respect of aid to promote or facilitate the development of certain regions.

Article 92 (3) (a) of the Treaty and 61 (3) (a) of the Agreement provide an exemption for aid for the benefit of regions suffering from problems of serious underdevelopment.

In Communication No 88/C 212/02 [1], as amended by Communication No 90/C 163/05 [2], the Commission explained the method of application of Article 92 (3) (a) and (c) to regional aid. In applying Article 92 (3) (a) of the Treaty and Article 61 (3) (a) of the Agreement, the Commission assesses the relative level of development of different zones compared with the Community average. For the purposes of those provisions, the socio-economic situation is assessed by reference to *per capita* GDP (gross domestic product)/PPS (purchasing power standard) using the Community index for the region. In a second stage the relative level of regional development is compared with the Community average. Therefore, regions to be classified as falling within the scope of Article 92 (3) (a) of the Treaty and Article 61 (3) (a) of the Agreement are the level II regions (on the basis of NUTS) which have a GDP/PPS threshold of 75 % or lower, thus indicating an abnormally low standard of living and serious underemployment. By applying these indicators the whole Portuguese territory (Autonomous Regions included) is deemed a region falling within Article 92 (3) (a) of the Treaty and Article 61 (3) (a) of the Agreement. On the basis of the available data, none of the Portuguese regions has a GDP/PPS higher than 75 % (the Portuguese GDP/PPS in the 1986 to 1990 period was 54 % of the Community average).

In principle, the Commission is opposed to exempt operating aid in the air transport sector. However, until the liberalization measures provided for by Regulation (EEC) No 2408/92 (and in particular in Article 4 concerning public service obligations) are fully applicable, compensation for public service obligations may be accepted under Article 92 (3) (a) of the Treaty and Article 61 (3) (a) of the Agreement.

[1] OJ No C 212, 12. 8. 1988, p. 2.
[2] OJ No C 163, 4. 7. 1990, p. 6.

Therefore compensation for the deficit incurred by TAP on the routes to the Autonomous Regions may benefit from the exemption laid down in Article 92 (3) (a) of the Treaty and Article 61 (3) (a) of the Agreement. The Commission has in fact expressly envisaged the possibility of granting an exemption pursuant to Article 92 (3) (a) to compensation for public service obligations, as promoting regional development (see Memorandum No 2, cited above). Given the degree of access to the market, the compensation of TAP's deficit is the only way to maintain life-line connections with the Autonomous Regions.

The compensation of TAP's deficit is an operating aid of regional character, being designed to overcome a permanent and structural disadvantage caused by the remote location of the Autonomous Regions.

In view of this situation it appears that, as long as the access to such routes is not entirely liberalized, the only way for the Portuguese Government to deal with the serious economic and social problems linked to the remoteness of the Autonomous Regions is to impose a public service obligation in respect of them, and to compensate the deficit incurred by TAP on those routes.

In the present case the Commission considers, on the basis of the elements provided by the Portuguese authorities, that the new method should not, in principle, lead to overcompensation of the deficit incurred by TAP on the routes to the Autonomous Regions. Therefore, the compensation may be considered as regional aid compatible with the common market and the Agreement, under Article 92 (3) (a) of the Treaty and Article 61 (3) (a) of the Agreement, subject to the condition that the compensation paid is not higher than the deficit incurred.

To that end, the Commission requires the Portuguese authorities to submit an annual report on the implementation of the aid scheme.

The Commission notes the Portuguese authorities' undertaking to apply Regulation (EEC) No 2408/92 to the routes in question as from 1 January 1996,

HAS ADOPTED THIS DECISION:

Article 1

The aid, notified by Portugal, to compensate the deficit incurred by TAP in fulfilling public service requirements on the routes to the Autonomous Regions of the Azores and Madeira is compatible with the common market and the EEA Agreement until 1 January 1996, as aid to promote the development of areas where the standard of living is abnormally low or where there is serious underemployment, provided that the aid granted does not exceed the deficit incurred on those routes.

Article 2

Portugal shall submit to the Commission an annual report on the implementation of the aid scheme.

Article 3

This Decision is addressed to the Portuguese Republic.

Done at Brussels, 6 July 1994.

For the Commission

Marcelino OREJA

Member of the Commission