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**Subject: State aid No SA.38168 (2014/N), ex. SA.37108 (PN/2013) – Croatia
Dubrovnik Airport Development**

Madam,

1 PROCEDURE

- (1) By electronic notification dated 14 January 2014, the Croatian authorities notified to the European Commission a measure concerning the renovation and development of the Dubrovnik Airport. The measure was registered under the state aid case number SA.38168.
- (2) By letter dated 15 January 2014 and registered with the Commission services on 17 January 2014, the Croatian authorities provided a language waiver whereby the adoption of this decision in the English language is accepted.

2 DESCRIPTION OF THE MEASURE

2.1 Dubrovnik Airport

- (3) Dubrovnik Airport is situated 25 kilometres from the city of Dubrovnik, in Dubrovnik & Neretva County. The airport mainly serves the South side of the Republic of Croatia (i. e. 5 towns, 17 municipalities and 230 settlements comprising around 130.000 inhabitants). It is the only Croatian airport in the South part of the country with international connections.

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- (4) Dubrovnik Airport is owned and operated by Dubrovnik Airport Ltd, a limited liability company fully owned by the Croatian State¹.
- (5) Over the last decade, traffic at Dubrovnik airport has been rising to around 1.5 million passengers in 2013, with average annual growth rates at 1.4% for domestic passengers and 1.9% for foreign passengers. Recent passenger traffic at the airport and expected development up to 2030 are as follows:

Table 1: Passenger development at Dubrovnik Airport 2009 – 2030

Actual passengers in 2009 – 2014:						
Year	2009	2010	2011	2012	2013	2014
Passengers (in million)	1.12	1.27	1.34	1.48	1.52	1.56 ²
Expected passenger development 2015 – 2030:						
Year	2015	2018	2021	2024	2027	2030
Passengers (in million)	1.66	2.0	2.48	2.88	3.28	3.69

- (6) The two closest airports are Tivat, in Montenegro (100 km from Dubrovnik) and Mostar, in Bosnia & Herzegovina (115 km from Dubrovnik).

2.2 The investment project and its financing

- (7) The envisaged investment project relates mainly to enhancements of the runway and new taxiways, but includes also landside and airside operational enhancements and upgrades.
- (8) The investment project at hand includes in particular the following measures:
- A reconstruction and upgrade of the main runway including the extension of taxiways, aprons and all necessary works (such as for example shielding to protect the extension embankment from the waves, construction of water drainage systems, road pavement and asphalt overlays, light signal systems, control systems, precision instrument landing systems).
 - Construction of parallel taxiways, including a reconstruction of aprons and open apron areas at the end of the main runway. This also includes the simultaneous creation of technical facilities (for example navigation lights, drainage works, precision markings, infrastructure remediation, replacement of road pavement layers and asphalt overlays).
 - Construction of terminal buildings for general aviation and administration and reconstruction of the main passenger terminal buildings necessary due to the technicalities of the project.

¹ The share capital is divided as follows: Republic of Croatia 55%, Dubrovnik-Neretva County 20%, Municipality of Konavle 15%, City of Dubrovnik 10%.

² Estimated.

- Fuel farm construction, waste management facilities, air bridges and electrical sub-stations.
- (9) The work is planned to be carried out until 2020 (including). The main objective of the measures is to improve efficiency and operational safety for aircraft handling at the airport that is currently restricted at peak times. With the projected enhancements Dubrovnik Airport’s capacity will be increased, enabling long-haul flights to take place.
- (10) The investment amounts to EUR 220 million. The total estimated investment costs can be broken down as follows:

Table 2: The investment project at Dubrovnik Airport.

Measure	Cost in 1,000 EUR
Aeronautical investments: Infrastructure and airside & non-airside suprastructures. Land purchases, Parallel taxiway construction, Upgrading of runway, Runway extension (including taxiway, connecting taxiways, aprons and relevant infrastructure works), construction of an aircraft rescue and fire-fighting facility etc.	200,000
“Non-aeronautical” economic activities (commercial areas, catering buildings, etc.) which are not eligible for State aid. Those investments are entirely financed through the airport’s own resources.	20,000
Total amount	220,000.00

- (11) According to the Croatian authorities investments amounting to EUR 220 million will be financed partially through public funding and partially through the aviation and non-aviation revenue of Dubrovnik Airport. The public funding will be granted to Dubrovnik Airport by the Croatian authorities in part under the framework of EU operational programmes (EUR 123.649,292 million) and directly from the Croatian National budget (EUR 21.820,463 million).
- (12) The Croatian authorities stated that the construction works of the infrastructure project will be tendered out in an open and non-discriminatory procedure. In the event that the projected costs are lower, the aid amount will be adapted so as not to exceed the funding gap of the project, that is, net present value of the difference between the expected costs to be incurred as a result of the project (that is, compared to a counterfactual scenario whereby the project would not be implemented), and the expected revenues to be generated as a result of the project, discounted over a relevant period. The aid will only be granted as a compensation of costs upon evidence of the payment to contractors.

2.3 Legal basis

- (13) The legal basis for the aid grant are State Aid Acts 140/2005 and 49/2011 as published in the Official Gazette³ of the Republic of Croatia concerning financial assistance for airport facilities in Croatia.

3 ASSESSMENT OF THE MEASURE

3.1 Existence of aid

- (14) By virtue of Article 107(1) of the TFEU "*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 internal market.*"
- (15) The criteria laid down in Article 107(1) of the TFEU are cumulative. Therefore, in order to determine whether the notified measures constitute State aid within the meaning of Article 107(1) of the TFEU all of the following conditions need to be fulfilled. Namely, the financial support:
- is granted by the State or through State resources,
 - favours certain undertakings or the production of certain goods,
 - distorts or threatens to distort competition, and
 - affects trade between Member States.

Economic activity and notion of undertaking

- (16) According to settled case law, the Commission must first establish whether Dubrovnik Airport Ltd. is an undertaking within the meaning of Article 107 (1) of the TFEU. The concept of an undertaking covers any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed⁴ and that any activity consisting in offering goods and services on a given market is an economic activity.⁵
- (17) In its "*Leipzig-Halle airport*" judgement the Court of Justice confirmed that the operation of an airport for commercial purpose and the construction of airport infrastructure constitute an economic activity⁶. Once an airport operator engages in economic activities, regardless of its legal status or the way in which it is financed, it constitutes an undertaking within the meaning of Article 107 (1) of

³ <http://www.nn.hr>

⁴ Case C-35/96 Commission v Italy [1998] ECR I-3851, para 36; C-41/90 Höfner and Elser [1991] ECR I-1979, para 21; Case C-244/94 Fédération Française des Sociétés d'Assurances v Ministère de l'Agriculture et de la Pêche [1995] ECR I-4013, para 14; Case C-55/96 Job Centre [1997] ECR I-7119, para 21.

⁵ Case 118/85 Commission v Italy [1987] ECR 2599, para 7; Case 35/96 Commission v Italy [1998] ECR I-3851, para 36.

⁶ Joint Cases T-455/08 Flughafen Leipzig-Halle GmbH and Mitteldeutsche Flughafen AG c/ Commission and T-443/08 Freistaat Sachsen and Land Sachsen-Anhalt c/ Commission, (hereafter: "*Leipzig-Halle airport case*"), [2011] ECR II-01311, confirmed by the ECJ, Case C-288/11 P Mitteldeutsche Flughafen and Flughafen Leipzig-Halle v Commission, [2012], not yet published in the ECR; see also Case T-128/98 Aéroports de Paris v Commission [2000] ECR II-3929, confirmed by the ECJ, Case C-82/01P, ECR 2002 Page I-9297, and Case T-196/04 Ryanair v Commission [2008], ECR II-3643.

the TFEU, and the Treaty rules on State aid are capable of applying to advantages granted by the State or through State resources to that airport operator⁷.

- (18) In this regard the Commission notes that the infrastructure, which is the subject of the present decision, will be operated on a commercial basis by the airport manager Dubrovnik Airport Ltd. Since the airport operator will charge users for the use of this infrastructure, the latter is commercially exploitable. It follows that the entity exploiting this infrastructure constitutes an undertaking for the purposes of Article 107 (1) of the TFEU.

State resources and imputability to the State

- (19) The grant of EUR 21.820,463 million in favour of Dubrovnik Airport Ltd. that originates from the budget of the Croatian government⁸ involves State resources, and is imputable to the State.
- (20) The public funding that is granted under the framework of EU operational programmes of approximately EUR 124 million, is transferred to the relevant national authority and body designated for that purpose by the Member State before being paid to Dubrovnik Airport Ltd. Therefore, also this funding is considered to be at the disposal of the Croatian authorities and thus involves State resources. As regards the imputability to the State, the Commission notes that in the context of the implementation of EU operational programmes the Croatian authorities enjoy a high degree of decision-making powers in the selection of the subsidised projects at national level. The decision to allocate part of the monies available to Croatia under the relevant EU operational programme has been taken by the Croatian authorities and is thus imputable to the State.

Economic advantage

- (21) The above-mentioned public funding reduces the investment costs that the airport operator would normally have to bear, if it wanted to expand or improve its efficiency, and therefore it confers an economic advantage on the airport operator.

Selectivity

- (22) Article 107 (1) TFEU requires that a measure, in order to be defined as State aid, favours "*certain undertakings or the production of certain goods*". The Commission notes that the advantages in question would be granted to Dubrovnik Airport Ltd only. Thus it is a selective measure within the meaning of Article 107 (1) of the TFEU.

Distortion of competition and effect on trade

- (23) When aid granted by a Member State strengthens the position of an undertaking compared with other undertakings competing in the internal market, the latter must be regarded as affected by that aid. In accordance with settled case law⁹, for

⁷ Cases C-159/91 and C-160/91, *Poucet v AGV and Pistre v Cancave* [1993] ECR I-637.

⁸ See point 11 regarding the amounts stemming from the national budget.

⁹ Case T-214/95 *Het Vlaamse Gewest v Commission* [1998] ECR II-717.

a measure to distort competition it is sufficient that the recipient of the aid competes with other undertakings on markets open to competition.

- (24) Airports with more than a million passengers per year compete to attract carriers. Therefore, there is competition between EU airports with more than a million passengers per year. As mentioned in paragraph 40 of the 2005 Aviation Guidelines, it is not possible to exclude that even smaller airports compete against other EU airports. The forecast in terms of traffic¹⁰ of Dubrovnik Airport shows an increase in traffic over the coming years. In addition, the measures at stake will allow Dubrovnik Airport to attract also airlines offering long-haul flights.

Conclusion

- (25) For the reasons set out above the Commission concludes that the public funding of the infrastructure measures at Dubrovnik Airport constitute State aid within the meaning of Article 107 (1) of the TFEU. Insofar as the grant was subject to Commission's approval, Croatia has respected the standstill obligation laid down in Article 108 (3) of the TFEU.

3.2 Compatibility of the aid

- (26) The Commission has assessed if the aid is compatible with the internal market.

Compliance with the 2005 Aviation Guidelines

- (27) The measure in question should be assessed upon the basis of Article 107 (3) (c) TFEU, which stipulates that: "*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*", may be considered to be compatible with the internal market. In this regard, the 2005 Aviation Guidelines provide a framework for assessing whether aid for the financing of airport infrastructures may be declared compatible pursuant to Article 107 (3) (c) TFEU. They set out a number of criteria which the Commission takes into account in this regard in its decision making practice.¹¹
- (28) It should be first noted that in this case, the amount of State aid (around EUR 145 million) does not exceed the costs of the investments that fall within the scope of the aided project and that relate to airport infrastructures and equipment or facilities that directly support them¹² (amounting to approximately EUR 200

¹⁰ See above, table 1.

¹¹ See for example Commission decision of 13 March 2001 - State aid Case N 58/2000 – Italy - Promotion of the Piedmont airport system, OJ C 67, 17 March 2004; Commission decision of 19 January 2005 – State aid N 644i/2002 – Germany – Development of municipal economic infrastructure pursuant to Part II, Section 7 of the Framework plan under the joint Federal Government / Länder scheme for improving regional economic infrastructure: (i) Construction or development of regional airports, OJ C 126, 25 May 2005; Commission decision of 20 April 2005 – State aid case N 355/2004 – Belgium – Public-Private-Partnership for tunnelling the Krijgsbaan at Deurne and the development of industrial estates and the operation of Antwerp Airport (PPP – Project Antwerp Airport), OJ C 175, 16 July 2005; Commission decision of 23 July 2008 - State aid case C 48/2006 (ex N 227/2006) – Germany – DHL/Leipzig Halle, OJ L 346, 23 December 2008.

¹² 2005 Aviation Guidelines, paragraph 55.

million). The notified aid will thus finance exclusively investment costs that are eligible under the 2005 Guidelines.

(29) According to point 61 of the 2005 Aviation Guidelines the Commission has to examine whether:

- the construction and operation of the infrastructure meets a clearly defined objective of general interest (regional development, accessibility, etc.);
- the infrastructure is necessary and proportional to the objective which has been set;
- the infrastructure has satisfactory medium-term prospects for use, in particular as regards the use of existing infrastructure;
- all potential users of the infrastructure have access to it in an equal and non-discriminatory manner;
- the development of trade is not affected to an extent contrary to the EU interest.

(i) Construction and operation of the infrastructure meets a clearly defined objective of general interest (regional development, accessibility, etc.)

(30) According to Croatia, the main aim of the financing of the infrastructure project at stake is to maintain and improve the accessibility of the region, and thus to stimulate the regional development and creation of new jobs.

(31) The closest airport to Dubrovnik airport is Tivat airport situated in Montenegro, 2 hours travelling time by car from the airport. There are no other means of transport, apart from the road network (built in 1963). In this context, the catchment area of Dubrovnik Airport (South Croatia) covers a total population of 200.000 residents and annually attracts around 1.5 million passengers, 64% of whom are foreign nationals, migrants and users of charter flights. The new investment thus concerns an airport which plays a pivotal role in the accessibility of South Croatia. Moreover, it will not constitute a duplication of existing non profitable infrastructure.

(32) Moreover, roads to Dubrovnik do not meet the requirements of tourist traffic while the vast majority of visitors reach South Croatia using charter flights with a direct connection from their home countries. This is particularly important as tourism plays an important role for Dubrovnik & Neretva's economy and the general development of the country.

(33) The project is aimed at meeting demand growth and decreasing congestion. The quality of existing infrastructure (runway, taxiway and apron) is not in line with safety requirements, which already threatens operations (the airport already operates at capacity limit). No interest of the private sector for investing into the airport has been identified.

(34) Without the project a significant decline in the quality of accessibility conditions to Dubrovnik and its region would be experienced, along with a total collapse of Dubrovnik airport's functionality.

- (35) The project will address the traffic isolation of the region and prepare it for the Schengen border status in 2016. Its development will boost quality of service, regional development, communal and social infrastructure.
- (36) In light of the touristic demand and for reasons of accessibility of South Croatia to tourists and the local population, this is of particular importance as tourism plays a central role in Croatia's economy and the general development of the country. The Commission observes that the development project at Dubrovnik Airport has a positive impact on tourism and jobs.
- (37) The Commission can therefore conclude that the construction and operation of the infrastructure meets a clearly defined objective of general interest.

(ii) The infrastructure is necessary and proportional to the objective which has been set

- (38) According to the Croatian authorities the existing facilities of the airport as they are currently laid out, in particular the runway and taxiway system, do not meet the requirements for unhindered aircraft handling. Thus, the airport suffers from congestion at peak times.
- (39) Moreover, for various reasons the current runway is considered as deficient infrastructure not suitable for purpose. The efficiency of the airport is seriously impaired (aircraft of the types Boeing B 747, B 767 and McDonnell Douglas MD 11 when fully fuelled and loaded require runways of between 2 925 m und 3 320 m for take-off). This deficiency had also significant impact on the financial situation of the airport. The reconstructed runway will reduce traffic limitation and will enable the airport to support long-haul flights.
- (40) The total terminal area at Dubrovnik airport is already reaching the capacity limit for current passenger volume, currently 26.000sqm for approximately 1.083 PAX, which is less than 24sqm per PAX and does not correspond with IATA Standards (25-30 sqm per passenger).
- (41) The existing terminal has eight passport arrival units and is capable to handle a DPH (Design Peak Hour) of 1.060 passengers per hour. Some of the terminal's main functions already operate beyond their capacity limit (check-in and security area). This partly leads to longer waiting times and awkward process conditions. The existing Passenger Terminal could be considered sufficient up to 2013; now the level of service is dropping until the new passenger terminal comes into operation in 2016.
- (42) The processing units must be improved (check-in, security control, baggage claim, passport control, etc.) as without any further development the airport will not be able to handle the forecasted traffic after 2016 in view of the Croatian's Republic unification with the Schengen Area.
- (43) The cost/benefit analysis submitted by the Croatian authorities provides that the infrastructure project will be undertaken only to the extent it is necessary to attain the goals set and that the project is not disproportionately large or elaborate.

- (44) The Commission can therefore conclude that the infrastructure in question is necessary and proportional to the objectives which have been set.
- (iii) The infrastructure has satisfactory medium-term prospects for use, in particular as regards the use of existing infrastructure
- (45) According to the forecast (passenger movements) provided by the Croatian authorities (see Table 1 above), the infrastructure project meets the medium-term demand of airlines and passengers. This is so in particular due to the absence of other airports that provide direct, scheduled access to South Croatia and the absence of alternative high speed train connections and the expected growth in passenger numbers.
- (46) Moreover, according to the information provided by the Croatian authorities the infrastructure project meets medium term demand of airlines and passengers.
- (47) On the basis of the above mentioned forecasts for passenger numbers, in the medium-term, the development project for Dubrovnik Airport offers good perspectives for use, especially in relation to existing infrastructure at the airport, which the planned works will optimise.
- (iv) All potential users of the infrastructure have access to it in an equal and non-discriminatory manner
- (48) The Croatian authorities confirm that the airport will be continue to be open to all potential users without any commercially unjustified discrimination.
- (v) The development of trade is not affected to an extent contrary to the interest of the EU
- (49) As previously indicated, even after the development of the airport infrastructure it is expected that it will serve for approximately 2.5 million passengers in 2021 and 3.7 million passengers in 2030, which will qualify Dubrovnik Airport according to the 2005 Aviation Guidelines as a large regional airport with an annual passenger volume between 1 and 5 million (category C).
- (50) As already indicated, the two closest airports are Tivat, in Montenegro (100 km from Dubrovnik) and Mostar, in Bosnia & Herzegovina (115 km from Dubrovnik). These two airports, which are not located in the EU, are not competing significantly against Dubrovnik Airport due to (i) their distance from Dubrovnik (ii) their small and segregated catchment areas (iii) the necessity to cross an EU-Schengen border in reaching them and (iv) the quality of the road network which results for instance in a 2 hour driving time between Tivat Airport and Dubrovnik Airport.
- (51) In mainland Croatia, the closest significant airport is Split, located more than 200 km away from Dubrovnik, which amounts to a 4 hour-drive. This airport is too remote from Dubrovnik Airport to be significantly impacted by the aided investments at Dubrovnik Airport. Moreover, there is no rail link between Dubrovnik and other cities (high-speed or conventional) nor are there plans to build any. Therefore, the aided investments do not significantly impact rail. On

the basis of the above, the Commission can therefore conclude that the development of trade is not affected to an extent contrary to the common interest.

- (52) The Commission considers that the public support in financing the enhancement of Dubrovnik Airport in accordance with the conditions described previously, is not prejudicial to the common interest and that the criteria set out in point 61 of the 2005 Aviation Guidelines have been satisfied in the present case.

Necessity and proportionality of the aid

- (53) In addition to the requirement to satisfy specific compatibility criteria specified in the 2005 Aviation Guidelines, State aid to airports, as any other State aid measure, should have an incentive effect and should be necessary and proportional in relation to the aimed legitimate objective in order to be cleared as compatible aid¹³.
- (54) The Commission must establish, whether the State aid granted to Dubrovnik Airport Ltd has changed the behaviour of the beneficiary undertaking in such a way that it engages in activity that contributes to the achievement of a public-interest objective that (i) it would not carry out without the aid, or (ii) it would carry out in a restricted or different manner. In addition, the aid is considered to be proportionate, only if the same result could not be reached with less aid and less distortion. This means that the amount and intensity of the aid must be limited to the minimum needed for the aided activity to take place.
- (55) In light of the multi-million scale of financing required, the prevailing economic downturn and the “funding gap” of the project at stake, private investors would not commit the level of funding necessary for this major infrastructure project, hence the airport's development would not have been pursued in the absence of the aid in question.
- (56) The Croatian authorities provided a calculation of the funding gap of the investment project at stake. This calculation consists in identifying the various revenues, investment costs and operating costs expected to arise because of the aided project, as compared with a counterfactual scenario whereby the aided project would not be undertaken. The funding gap of the project corresponds to the difference between costs and revenues expected to arise because of the project, calculated using an appropriate discount rate. In this case, the calculation shows that the aid amount would be lower than the funding gap of the aided project (around EUR 150 million).
- (57) This calculation of the funding gap takes into consideration all revenues and costs related to the aided project, including costs and revenues linked to non-aeronautical investments falling within the airport's economic activities, that is investments other than those relating to airport infrastructures and equipment or facilities. An example of such non-aeronautical economic investment is the construction of a new catering building. The Croatian authorities provided a calculation of the specific funding gap of these non-aeronautical economic

¹³ It is constant case law that the Commission can declare an aid compatible only if it is necessary for achieving a legitimate objective (cf. case 730/79, Philipp Morris, paragraph 17; case C-390/06, Nuova Agricast, paragraph 68; case T-162/06, Kronoply, paragraph 65).

investments which shows that this specific funding gap is positive. This means that the non-aeronautical economic investments are expected to generate a profit which will contribute to the financing of the aided investments. The general funding gap of the project (around EUR 150 million) reflects the need for public funding as a complement to the profit expected to be generated by the non-aeronautical economic investments in order to make the overall project economically viable.

- (58) Therefore, the fact that the aid amount does not exceed the general funding gap of the projects shows that it is limited to the minimum necessary to make the overall project economically viable.
- (59) Consequently, the aid will enable the beneficiary to realise the investment, has an incentive effect and is proportional.

Conclusion

- (60) In view of the above assessment the Commission concludes that the measure is compatible with the internal market on the basis of Article 107 (3) (c) of the TFEU.

4 DECISION

The Commission has accordingly decided to consider that:

- The acquisition of land, the modernisation of infrastructure and other measures notified by the Croatian authorities to be financed through public funding amounting to EUR 145 million, constitute aid compatible with the internal market on the basis of Article 107 (3) (c) of the TFEU and not to raise objection against it.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

<http://ec.europa.eu/competition/elojade/isef/ndex.cfm>

Your request should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

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