EUROPEAN COMMISSION

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Subject: State aid SA.35720 (2014/NN) (ex 2012/PN) – United Kingdom Liverpool City Council Cruise Liner Terminal

Sir,

1. PROCEDURE

(1) On 9 June 2011, the Associated British Ports ("ABP"), a UK ports group and the operator of *i.a.* cruise terminals, expressed concerns in respect of funding provided by public authorities in the UK to the Liverpool City Council ("LCC", "the Council") to build the Liverpool City Council Cruise Liner Terminal ("the Terminal") and of the proposals for a change of use of the Terminal. The case was registered as *SA. 34194 (2012/CP) – Alleged aid to Liverpool Cruise Terminal*. ABP requested the Commission, in particular, to seek further information from the UK Government on the nature and status on the above proposals.

(2) Between 29 July 2011 and 4 June 2013, ABP made further submissions with additional information to substantiate the complaint. The Commission requested information from the UK authorities between 8 August 2011 and 24 October 2012, in order to clarify the facts alleged by the complainant.

(3) On 1 October 2012 the Commission communicated to the complainant its preliminary findings concerning the proposed change of use of the Terminal and informed that at that moment it was not in a position to take a view as regards the application of State aid rules to the alleged measures.

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(4) In reaction to the complaint, on 15 November 2012 the UK authorities pre-notified the infrastructure investment in the Terminal, which was registered as *SA.35720 (2012/PN) – Liverpool City Council Cruise Liner Terminal*. The UK authorities had the aim to seek legal certainty as they considered that the public funding for the Terminal did not involve State aid within the meaning of Article 107 of the Treaty on the Functioning of the European Union ("TFEU"). The Commission requested additional information on 3 April 2013, 14 June 2013 and 17 June 2013 to which the UK replied on 13 June 2013, 24 June 2013 and 12 July 2013. The complainant also submitted further information.

(5) Since the information available showed that the public funding had already been disbursed, on 3 February 2014, the Commission informed the UK that as a result of the violation of the stand-still clause laid down in Article 3 of Council Regulation No 659/1999, the aid measure had been registered as unlawful aid (2014/NN) and the procedural rules applicable would be those laid down in Chapter III thereof.

2. DESCRIPTION

2.1. Background

(6) In 2006 the Council received public funding of GBP 17.8 million from the UK local authorities ("UK grant") and the European Regional Development Fund (“ERDF”) for the construction of the Terminal.

(7) In order to alleviate competition concerns and to meet the requirements of the UK ports policy, the UK grant was awarded with, as explained by the UK authorities, an "implicit understanding" that the Terminal would be used only as a "port of call". Ports of call handle only transit vessels, in contrast to "turnaround ports" where cruise journeys start and end. The latter are considered more attractive as they generate more income for cruise terminal operators. The ERDF grant was not subject to any restriction on the use of the Terminal.

(8) The Terminal began operations in 2007 as a port of call. By 2009, however, LCC sought permission from the UK Government to use the Terminal for turnaround operations. These attempts were initially unsuccessful but raised concerns of ABP, the operator of *i.a.* competing cruise terminals in Southampton, which lodged a State aid complaint.

(9) On 22 May 2012, following a public consultation, the UK Government expressed, in a public statement of its Parliamentary Under-Secretary of State for Transport, its readiness to remove the turnaround "restriction" provided that part of the grant is repaid and that State aid clearance is obtained from the Commission. On 29 May 2012, the Terminal began handling turnaround operations.

(10) In September 2012 LCC repaid from own resources GBP 8.8 million of the UK grant to fulfill the first of the above conditions. The amount of repayment was calculated on the basis of the initial value of the UK grant adjusted by accumulated depreciation of the Terminal from its construction until the change of use and was validated by an external consultant. Before its decision, the Council considered also an alternative way of repayment which provided for a phased repayment of GBP 12.6 million over a period of 15 years.

Position of the complainant

(11) ABP contends that the Council received State aid within the meaning of Article 107(1) TFEU in the following forms:

(i) the remaining public funding of the Terminal (i.e. after the partial repayment of the UK grant) retained by the Council;

(ii) the change of use of the Terminal;

(iii) the terms of repayment of the UK grant and in particular:

(a) the option to repay GBP 12.6 million over a 15 year period at an implied interest rate of 4.9% which is allegedly below a commercial rate and

(b) the lack of restriction on the source of repayment which allowed LCC to make the repayment from its own (public) resources.

(12) In view of the complainant, the above State aid is not compatible with the internal market because it is not necessary and proportional, serves no objective of common interest and may have a significant impact on competition.

(13) In addition, ABP informed the Commission that the UK Government awarded a grant of up to GBP 35 million to the Mersey Docks and Harbour Company ("MDHC"), the Liverpool port authority, for dredging the River Mersey and Liverpool Bay. ABP has requested the Commission to ensure that its assessment of the State aid granted for the construction of the Terminal takes account of the proposed dredging grant and, in particular, the expected impact of the dredging on future traffic to the Terminal. ABP claims that, after the dredging, the Terminal will be able to attract more traffic thanks to a longer tidal window and a wider range of arrival and departure times.

Position of the UK

(14) The UK authorities are of the opinion that both the initial public funding and the subsequent change of use of the Terminal do not involve State aid. They argue that the public funding was provided for the development of general port infrastructure for the benefit of all, on a non-discriminatory basis (non-user specific), and that the support was provided to LCC (i.e. an extension of the State) which built and owns the Terminal. They stress that no selective advantage was conferred on any undertaking and that all users of the Terminal (cruise shipping companies) were (and still are) charged a market rate, which is established on the basis of an objective factor, i.e. gross tonnage of a vessel.

The rates are established by the Council based upon an annual market analysis of the rates charged by other UK ports. The UK authorities also claim that the change of use did not involve the transfer of any State resources and, therefore, did not involve State aid.

(15) According to the UK authorities, the dredging of the River Mersey and Liverpool Bay could reasonably be considered to be a general infrastructure of benefit to multiple stakeholders and in the general economic interest of the wider area and hence non-aid. It will benefit a number of undertakings located within the Liverpool port, e.g. the Essar/Shell crude oil terminal at Tranmere, the Eon coal terminal, the Cargill terminals within the Liverpool dock system, the 12 Quays terminal and the new container terminal. It will also improve the access to a further inland waterway, the Manchester Ship Canal and the ports located therein.

(16) The UK authorities acknowledge that the project will also benefit the Terminal, however, they stress that it will not be the sole or even primary beneficiary of the dredge. It is also noted that the dredging was not related to the construction of the Terminal.

(17) The UK authorities explained that dredging in the Mersey estuary is carried out in order to allow the adjustment of the estuary and further inland waterway to the developments in the vessel industry as regards the size and type of vessels. It will for instance allow the access of post-Panamax container ships to the estuary.

(18) According to the UK authorities, the Council is aware that the dredging will result in an altered tidal pattern and understands that it is likely to result in a larger time window for cruise ships to enter and leave the port. At this stage the Harbour Master has been unable to confirm to the Council the exact changes to the tidal patterns and therefore the Council is unable to determine what exact benefit this might bring in terms of Terminal operation. The Harbour Master notes, however, that an optimistic view suggests that additional 10 day-calls per year may be possible. There is no indication from the Council that these days, if indeed available, would be used.

2.2. Construction and operation of the Terminal

(19) The purpose of the investment was to construct a floating pontoon-based passenger terminal (landing stage) at Princes Dock, a location adjacent to the Liverpool City Center, which would be suitable for berthing large cruise ships, exhibition and naval vessels.

(20) The existing berthing facility at the Pier Head was deemed to be inconveniently located and expensive, limiting the number and size of ships able to visit Liverpool and not allowing to fully exploit the potential of a cruise market for the city and the broader North West region, one of the least developed areas of the UK. The Terminal was thus also expected to offer significant regeneration benefits for the local economy.

(21) The investment was completed in 2007 and consisted of four major components:

(a) the purchase, delivery and setting of the pontoons;

(b) the creation of a linkspan bridge;

(c) the creation of a floating roadway;

(d) the creation of relevant car parking facilities.

(22) The Terminal is located within the Port of Liverpool. The Council leases the sea bed underneath the Terminal from MDHC, which itself leases it from the Duchy of Lancaster (i.e. the Crown).

(23) LCC fully owns and operates the Terminal, without any other intermediary entity involved (e.g. concessionaire). The Council charges berthing fees for use of the Terminal, whereas the port authority and operator, MDHC, which is owned by a private company named Peel Ports, charges harbour fees from all visiting vessels in defrayment of its maritime and vessel traffic services. According to the UK authorities, all allowable types of vessels have equal and non-discriminatory access at market rates to the Terminal.

2.3. Financing of the Terminal

(24) The total actual cost of the investment amounted to GBP 17.8 million and was fully financed from public sources.

(25) According to the UK authorities, before undertaking the investment, LCC was in contact with potential private sector partners. Their view was that Liverpool would not attract the required amount of cruise traffic to make the investment financially viable.

(26) In order to decide on the investment, the Council conducted a net present value ("NPV") analysis for the Terminal[1]. According to the NPV analysis performed as of 2006, over a reference period of 20 years, the investment had a negative NPV of minus GBP 16.7 million, if the Terminal was to be used as a port of call only, or minus GBP 16.5 million, if the Terminal was to be used as a port of call for the first five years of operations and as a turnaround facility for the remaining economic useful life.

(27) The funding gap ratio of the investment (i.e. NPV divided by discounted costs of the investment), the measure which approximates the share of the investment cost that will not be recovered from the future operation of the Terminal, amounted to 99.2%, if the Terminal was to be used as a port of call only or 98%, if the Terminal was to be used as a port of call for the first five years of operations and as a turnaround facility for the remaining economic useful life.

(28) The UK authorities have provided the actual financial results of the Terminal recorded during the first six years of operations. In the light of the actual financial results and the actual use of the Terminal, it results that the NPV amounts to minus GBP 16.4 million and the funding gap ratio amounts to 97.5%.

[1] The NPV measures the present value of net cash flows (discounted revenue minus discounted costs) expected to be generated by the investment over its economic life. In principle, an investment is undertaken by a private investor, when the NPV is positive.

2.4. Competition context

(29) According to the UK authorities, the construction of the Terminal has not resulted in a significant distortion of competition at the UK and the EU level.

(30) The Terminal's share in the port of call segment is estimated by the UK authorities at 4% of the UK market.

(31) The UK authorities estimate the current share of the Terminal in the UK turnaround market at 1.1%. By way of comparison, according to data of the UK Department for Transport, the market shares of selected other UK ports are estimated at: Southampton – 56%, Dover – 14%, Harwich – 4%. According to the European Cruise Council the UK accounts for ca. 15% of the EU cruise market[2]. On that basis, the share of the Terminal on the EU turnaround market would amount to 0.17%.

(32) The Terminal has added relatively small capacity on the UK and the EU turnaround cruise port markets. The total annual number of turnaround cruise passengers at the Terminal is estimated at: 13,200 in 2013 and 14,000 in 2014-2016. To put it in proportion, according to the UK authorities, the UK turnaround market in 2012 accounted for 807,000 passengers and has been growing between 2004 and 2012 at an average pace of 13% p.a. The Council believes that the Terminal would aim to ultimately increase its turnaround numbers to a target figure of ca. 20,000 passengers p.a. Assuming a static cruise market in the UK this would represent a 2.5% market share. However, the market is likely to grow, in keeping with the trend in the period 2004-2012.

(33) Prior to the construction of the Terminal, Peel Ports operated a cruise facility in Liverpool - at Langton Dock. The facility was however unpopular due to its inconvenient location and discouraged cruise lines from choosing Liverpool as a destination. In addition, access to this site was difficult due to the complexity of the lock system (used to facilitate access to the port in conditions of changing tides). Conversely, the Terminal is situated in a much more convenient location, as it allows vessels to avoid the lock system and is closer to the Liverpool city centre.

(34) Langton Dock ceased to berth cruise ships once the Terminal began handling turnaround voyages. The UK authorities have explained that in effect, the Terminal has to a certain extent only replaced the capacity formerly provided by the Langton Dock. In 2006-2011 Langton Dock handled from 6 to 22 turnaround calls per year and between 4.3 and 7.6 thousands of passengers. In comparison, the Terminal handled 11 turnaround calls in 2012 and is forecasted by the Council to handle 15 such calls each year between 2013 and 2016.

(35) In addition, the UK authorities argue that the construction of the Terminal is likely to improve the general accessibility and attractiveness of the UK trans-Atlantic turnaround cruising and to attract additional US cruise passengers into Europe which could lead to an increase of the overall market size.

[2] European Cruise Council's report *The Cruise Industry (2010 edition).*

2.5. Legal basis

(36) According to the UK authorities the legal bases for the funding of the Terminal are: Local Government Act 2000 (Chapter 22), Regional Development Agencies Act 1998 (Chapter 45) and ERDF Council Regulation 1260/1999.[3]

2.6. Cumulation

(37) The UK authorities undertook that the aid received for this project has not been cumulated with aid received from other local, national or EU sources for the same eligible costs.

3. THE AID MEASURE

(38) The public funding for the construction of the Terminal was provided in the form of grants from the following sources:

North West Development Agency:	GBP 7,156,294
Single Regeneration Budget:	GBP 1,875,780
Mersey Waterfront Regional Park:	GBP 157,858
Total UK grant:	GBP 9,189,932
European Regional Development Fund:	GBP 8,623,011
Total:	**GBP 17,812,943**

(39) The aid intensity amounts to 100%.

4. ASSESSMENT

4.1. Existence of aid

(40) Article 107(1) TFEU stipulates that 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 and affects trade among Member States is incompatible with the internal market.

(41) It follows that, for a measure to be qualified as State aid within the meaning of Article 107(1) TFEU, the following cumulative criteria must be met: use of state resources, selective advantage to the beneficiary and (potential) distorting effects on competition and trade between Member States.

[3] Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds, OJ L 161, 26.6.1999, p.1.

(42) In the present case, the existence of State aid must be examined at the level of LCC, which is the owner and operator of the Terminal, and the users (cruise shipping companies).

4.1.1. Existence of aid at the level of the owner and operator of the Terminal (LCC)

The notion of undertaking

(43) According to established Court jurisprudence[4], whenever an entity is engaged in an economic activity, regardless of its legal status and the way in which it is financed, it can be considered as an undertaking for the purposes of the EU competition law. The Commission established in a series of decisions that the exploitation of some types of ports infrastructure, including cruise terminals, can be considered as being of an economic nature.[5]

(44) Furthermore, according to the *Leipzig-Halle* judgment,[6] it is the future use of the infrastructure, i.e. whether the infrastructure shall be commercially exploited or not, which determines whether its construction constitutes an economic activity and falls within the scope of the EU State aid rules. It is irrelevant for the classification of a certain activity as economic whether a private investor would carry it out or not.

(45) The measure under scrutiny concerns the funding provided for the construction of a cruise terminal, which is commercially exploited by the Council through a provision of services to cruise liners against remuneration. In view of the above, the Commission considers that the financing of the construction of the Terminal, taking account of its subsequent commercial operation, supports an economic activity performed by the Council. The latter, for this purpose, is deemed to be an undertaking, which falls within the scope of Article 107 TFEU.

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[4] See e.g. Case C-41/90 *Hofner and Elsner* [1991] ECR I-1979, para. 21; C-160/91 *Poucet and Pistre v. AGF and Cancava* [1993] ECR I-637, para. 17; Case C-35/96 *Commission v. Italy* [1998] ECR I-3851.

[5] For cruise terminals see Commission Decision of 19.06.2013 in State Aid case no. SA.35738 (2012/N) - *Aid for the upgrading of Katakolo port*, OJ C 204 of 18.07.2013;Commission Decision of 02.07.2013 in State Aid case no. SA.35418 (2012/N) – *Extension of Piraeus port*, OJ C 256 of 05.09.2013. For other types of ports infrastructure see e.g. Commission Decision of 15.12.2009 in State Aid case no. N 385/2009 – *Public financing of port infrastructure in Ventspils Port*, OJ C 72 of 20.03.2010; Commission Decision of 15.06.2011 in State aid case no. 44/2010 *Public financing of port infrastructure in Krievu Sala*, OJ C 215 of 21.7.2011; Commission Decision of 22.02.2012 on State aid case no. SA.30742 (N/2010) *Construction of infrastructure for the passenger and cargo ferries terminal in Klaipeda*, OJ C 121 of 26.4.2012; Commission decision C(2012) 9468 final of 19.12.2012 on State aid SA.34940 (2012/N) *Port of Augusta*, OJ C 77 of 15.03.2013.

[6] Joined cases T-455/08 *Flughhafen Leipzig-Halle GmbH and Mitteldeutsche Flughafen AG v. Commission* and T—443/08 *Feistaat Sachsen and Land Sachsen Anhalt v. Commission* [2011] ECR II-0000. See also Case T-128/89 *Aéroports de Paris v. Commission* [2000] ECR II-3929, confirmed by the ECJ in Case C-82/01P [2002] ECR I-9297 and Case T-196/04 *Ryanair v. Commission* [2008] ECR II-3643, paragraph 88.

State resources and imputability

(46) The UK grant was provided by local authorities from public funds which amount to State resources. ERDF grant was placed at a disposal of the UK authorities, in particular the relevant Managing Authority, before being paid to LCC and therefore it also amounts to State resources.

(47) The UK authorities enjoy a high degree of discretion in the selection of the projects and in the allocation of the funds to the investments co-financed by the ERDF, such as the Terminal. The present investment was directly chosen by the UK authorities and, accordingly, the use of State resources is therefore imputable to the UK.

Selective economic advantage

(48) The public funding was provided in the form of a grant, which is non-repayable and carries no finance cost. Whereas, on the one hand, it is apparent from recital 25 that potential private partners did not find the project attractive enough on market terms, on the other hand, the Council would not have obtained financing to build the Terminal on such favourable terms on the capital market. Therefore, the public funding provided the Council with an economic advantage in the form of financing below market conditions. This economic advantage was granted specifically to LCC and is, therefore, selective.

Distortion of competition and effect on of trade between Member States

(49) According to established case law, when the financial support granted by a Member State strengthens the position of an undertaking compared to other undertakings competing and engaged in trade between Member States, then there is at least a potential effect on competition and on trade between Member States.[7]

(50) The selective economic advantage benefitting the Council has allowed it to build and operate the Terminal, thus strengthening its position vis-à-vis other competing port operators in the UK and in other EU Member States. Indeed, different ports in the UK and other Member States also receive cruise ships and are at least potentially in competition with the Terminal to attract cruise traffic. The public funding is therefore liable to affect competition and trade between Member States.

(51) In view of the above, the public funding granted for the construction of the Terminal constitutes State aid in the meaning of Art. 107(1) TFEU.

[7] See e.g. Case 730/79 *Philip Morris v. Commission* [1980] ECR 2671, para. 11, and Case C-372/97 *Italy v. Commission* [2004] ECR I-3679, para. 44.

4.1.2. Existence of aid at the level of Terminal users (cruise shipping companies)

(52) All allowable types of vessels enjoy equal and non-discriminatory access to the Terminal and are charged market rates for use of the Terminal. No company is given any priority and berthing fees are charged on the basis of an objective factor and established upon annual market analysis of the rates charged by other UK ports, as indicated in recital 14. In view of the fact that the Terminal shall be available to all potential users and that there is no connection between the fees which cruise shipping companies using the Terminal will pay and the grant given to LCC, the grant does not confer any selective economic advantage to cruise shipping companies and, therefore, does not specifically favour any one of these undertakings within the meaning of Article 107(1) TFEU.

4.1.3. Alleged aid in the change of use of the Terminal

(53) In addition to the public funding granted for the construction of the Terminal, the complainant alleges that the change of use in itself constitutes State aid and a breach of grant condition (i.e. the turnaround "restriction").

(54) The mere change of use of the Terminal from a port of call to a turnaround facility does not involve any additional transfer of State resources to the Council. According to case law, only advantages granted directly or indirectly through State resources are to be considered as aid within the meaning of Art. 107(1) TFEU.[8] The change of use does not fulfil this condition and, therefore, it does not constitute State aid on its own, contrary to the complainant's allegation.

(55) As regards whether the change of use of the Terminal constituted additionally a breach of grant condition, the Commission first notes that this allegation does not raise any State aid issues. Regardless of that, in response to the complainant's request, it has examined the allegation and found as follows.

(56) Council Regulation No 1260/1999, which applies to ERDF co-financing of the Terminal, does not lay down any use restrictions on financing of port infrastructure and, accordingly, the original ERDF grant letter and subsequent amendments did not include any turnaround "restriction". Consequently, the use of the Terminal for turnaround operations does not constitute a breach of the ERDF grant conditions.

(57) When it comes to the UK grant, according to the UK authorities, there was no explicit exclusion of turnaround use within any of the national grant agreements but only an "implicit understanding" that the Terminal will be used as a port of call in order to meet the requirements of the UK ports policy. In any event, the partial repayment of the UK grant by the Council in return for releasing the turnaround "restriction", as required by the UK Government, was aimed to ensure compliance with this policy.

4.1.4. Alleged aid in the terms of repayment of the UK grant

[8] Case C-379/98 *Preussen Elektra AG* v *Schleswag AG* [2001] ECR I-2099, para. 58.

(58) ABP also alleges that the terms of repayment of the UK grant involved State aid in the form of:

(a) the option to repay GBP 12.6 million over a 15 year period at an implied interest rate of 4.9% which is allegedly below a commercial rate and

(b) the lack of restriction on the source of repayment which allowed LCC to repay from its own (public) resources.

(59) Concerning the first allegation, the complainant argues that one of the repayment options proposed by the Council providing for the repayment of GBP 12.6 million over a period of 15 years carried an implied interest rate of 4.9% and that this was not a commercial rate, considering that ABP issued 15 year bonds in December 2011 at an effective rate of 6.295%. The complainant was of the opinion that the proposed option would have resulted in an undue economic advantage to LCC.

(60) The Council did not decide to pursue the option questioned by the complainant but chose instead a lump sum repayment of GBP 8.8 million. Thus the first allegation has become without object.

(61) Concerning the second allegation, the complainant argues that the lack of restriction on the source of repayment constituted State aid as it allowed the Council to replace one form of public funding (i.e. the original UK grant) with another (i.e. the Council's own public resources from which the repayment was made).

(62) The repayment was made for the purpose of meeting the UK domestic port policy requirements. In the present context it is irrelevant to assess whether the chosen source of repayment served the required purpose of the UK ports policy or not.

(63) As regards the alleged State aid character of the measure, the repayment led to an outflow of the Council's resources. As such, it cannot constitute an autonomous and additional aid measure in favor of LCC.

4.1.5. Grant awarded to MDHC for dredging the River Mersey

(64) As alleged by the complainant, the UK's Regional Growth Fund awarded a GBP 35 million grant to MDHC, the Liverpool Port authority, for the capital costs of dredging in the River Mersey estuary. The project comprises the dredging of the approach channel in the estuary of the River Mersey to a depth of 16 m with the aim to facilitate access to the Liverpool port and the Manchester Ship Canal.

(65) The Commission acknowledges that the grant involves State resources which are imputable to the State.

(66) However, the dredging in question is to be regarded as public works in the general interest, which cannot be regarded as conferring a selective economic

advantage to any particular operator in the Mersey estuary. In particular, the dredging is not solely related to the construction and operation of the Terminal, which is only one of the many users located in the Mersey estuary, and is run by a different undertaking than the beneficiary of the grant

(67) Indeed, the UK authorities have supported dredging in that estuary, in order to adjust the depth to the developments in the vessel industry, beyond the specific needs of cruise vessels which concern the Terminal. The dredging funded by the UK authorities would improve access to the river and benefit indistinctly all the operators located in the estuary and along a further inland waterway, the Manchester Ship Canal.

(68) The Commission therefore concludes that in the present case dredging is a public work aimed at maintaining access to maritime routes for the benefit of the maritime community as a whole. As such it appears to be expenditure incurred by the State in the framework of its responsibilities for planning and developing a maritime transport system in the interest of the general public and hence does not benefit a particular undertaking[9].

(69) Against this background, the Commission concludes that the grant awarded to MDHC for dredging the River Mersey does not constitute state aid.

4.2. Legality of the aid

(70) In accordance with Article 3 of Council Regulation No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty[10], aid shall not be put into effect before the Commission has taken, or is deemed to have taken, a decision authorising such aid ("standstill obligation").

(71) In the present case, UK did not fulfil the stand-still obligation as the aid was granted in 2006. Thus, the measure is considered as non-notified aid.

4.3. Compatibility of the aid

(72) Insofar as the measure identified above constitutes State aid within the meaning of Article 107(1) TFEU, its compatibility must be assessed in the light of the exceptions laid down in paragraphs 2 and 3 of that Article.

(73) According to established practice,[11] the appropriate legal basis for assessing compatibility of the State aid to port infrastructure is Article 107(3)(c) of the Treaty. In keeping with that practice, it should therefore be examined if the aid in favour of the Terminal meets a clearly-defined objective of common interest, is necessary and proportional to this objective, and does not affect

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[9] See e.g.: Commission Decision of 20.10.2004 in State Aid case no. N 520/2003 - *Financial support for infrastructure works in Flemish ports*, OJ C 176/12 of 16.07.2005 and Commission Decision of 21.12.2005 in State Aid case no. N 503/2005 – *Great Yarmouth Outer Harbour*, OJ C 083/2006 of 06.04.2006. See also: Commission Communication COM (2001) 35 final of 13.02.2001 Reinforcing Quality Service in Sea Ports: A Key for European Transport, p. 11.

[10] OJ L 83, 27.3.1999, p.1 with further amendments.

[11] See the recent Commission Decisions on port infrastructure projects cited in footnote 5.

competition and trade between Member States to an extent contrary to the common interest.

4.3.1. Objective of common interest

(74) The Commission laid out its strategic goals for the European maritime policy in the 2009 *Communication on Strategic Goals and Recommendations for the EU Maritime Transport Policy until 2018*,[12] identifying key areas, where action by the EU would strengthen the competitiveness of the sector while enhancing its environmental performance. The Commission underlined in particular that port infrastructures should ensure the exploitation of the full potential of short-sea shipping and sea transport services for business and citizens in Europe. In that respect, the Communication concluded that providing new port infrastructure as well as improving the use of existing capacities, including for ferries and cruise ships, was essential to ensure that ports can cope efficiently with their gateway and connection functions.

(75) In its Communication *Ports: an engine for growth*,[13] the Commission underlines that ports can contribute significantly to the economic recovery and long term competitiveness of European industries in world markets while adding value and jobs in all EU coastal regions, and that funding and financing transport infrastructure and facilities is one of the key challenges for the EU transport network in the years to come.

(76) In recent decisions, the Commission considered that the objectives of transport policy were met by several types of ports, including cruise terminals in Greece[14], or port infrastructure for the transport of ferry passengers in Lithuania, which could potentially be used for cruise vessels[15].

(77) The Terminal is situated in a convenient location which allows vessels to avoid the lock system and close to the Liverpool city centre. As further illustrated in recitals 33 and 35 above, the Terminal is likely to foster increased demand for transport services.

(78) The construction of the Terminal will allow a better exploitation of sea transport services and in particular the development of activities linked to the cruise industry. The above elements demonstrate that the investment contributes to an objective of common interest, in particular the EU maritime transport policy.

4.3.2. Necessity and proportionality of the aid

(79) According to the NPV analysis conducted by the Council as of 2006 the investment was expected to generate a negative NPV of minus GBP 16.7 million, if the Terminal was to be used as a port of call only, or minus GBP 16.5 million, if the Terminal was to be used as a port of call for the first five

[12] Communication of 21 January 2009, COM(2009) 8 final.
[13] Communication from the Commission: *Ports: an engine for growth*, COM (2013) 295.
[14] See footnote 5.
[15] Commission Decision of 22.02.2012 on State aid case no. SA.30742 (N/2010) *Construction of infrastructure for the passenger and cargo ferries terminal in Klaipeda*, OJ C 121 of 26.4.2012.

years of operations and as a turnaround facility for the remaining economic useful life.

(80) As the Terminal changed its use in 2012, the Commission has to assess the necessity and proportionality of the aid on the basis of the actual use, i.e. that the Terminal was used as a port of call for the first five years of operations and as a turnaround facility for the remaining economic useful life. The analysis is based on the actual figures for the years predating the decision and on the basis of the forecast for the period thereafter. The Commission observes that in such a case the NPV of the Terminal amounts to minus GBP 16.4 million.

(81) The Commission has consistently accepted that port infrastructure projects require considerable capital investments that can only be recovered in a very long term, and their economic viability may not normally be ensured without public funding.[16] Since in the present case NPV is significantly below zero, irrespective of the use of the Terminal as port of call or as turnaround port, it is very unlikely that any rational market investor would have been ready to finance the construction of the Terminal.

(82) ABP has requested the Commission to scrutinize closely the financial analysis performed by the Council and to consider whether it is credible. The complainant was concerned that the analysis may have presented too pessimistic view in order to justify an unduly high public funding. The examination of the analysis, including its key underlying parameters, shows as follows.

(83) The number of cruise calls assumed in the NPV analysis in the first six years of operations turned out to be much higher than the actual number of vessels that visited the Terminal in this period. Also the number of cruise calls (including turnaround) that was assumed in the NPV analysis for the coming years was higher than what is currently forecasted by the Council. The above indicates that the number of vessels assumed in the analysis was not underestimated.

(84) As regards the discount rate of 5.81%, each undertaking has its own rate, based, *inter alia*, on its cost of capital. Nevertheless, the assumed value does not appear unusually high, considering that it is equal to the Commission's reference rate for the UK which aims to approximate the financing cost of a healthy firm. According to the Communication from the Commission on the revision of the method for setting the reference and discount rates[17], the reference rate is also to be used as a discount rate for calculating present values. Moreover, the Commission observes that the LCC is not rated by any agency but its financial situation in FY 2005/06 (i.e. when the investment was undertaken) was healthy. The Council had surplus on its revenue account and its average interest rate on the long-term borrowing was 5.91%. Therefore the discount rate of 5.81% is surely not overstated, since it was even below the financing cost of the Council.

[16] See the recent Commission Decisions on port infrastructure projects cited in footnote 6.
[17] OJ C 14/02 of 19.01.2008.

(85) The above findings indicate that the NPV analysis was based on prudent assumptions in the sense that it did not overestimate the necessary amount of public funding.

(86) In view of the above, the public funding was necessary and had an incentive effect, insofar as it enabled LCC to undertake an investment that, in the absence of public support, neither the Council nor any market investor would have undertaken.

(87) As regards proportionality, i.e. keeping public funding down to the minimum necessary, according to the Commission's decisional practice in the funding of port infrastructure (see footnote 5 above), State aid is considered proportional if the aid intensity (i.e. the proportion of public funding to the investment cost) is limited to the funding gap ratio (defined as NPV divided by discounted total cost of the investment).

(88) It stems from the Commission's decisional practice that the level of public funding for each project is the function of certain variables, such as the kind of activities to be carried out within the infrastructure, volume and seasonality of traffic, expected revenues and costs of constructing the infrastructure, etc., which depend on the specific features of each infrastructure project.

(89) The cruise industry is subject to high seasonal deviations, since transport of passengers by cruise ships is significantly reduced during winter time, which means that port revenues from cruise passengers are more volatile (i.e. subject to higher risk) and lower than the revenues from other types of ports that operate throughout the whole year. In view of this, a relatively higher aid intensity for cruise terminals than for other types of port infrastructure (e.g. freight ports) should not be regarded as unusual.

(90) In the present case, the aid intensity amounts to 100% and is higher than the funding gap ratio which amounts to 97.5%, calculated as explained in recital (28) above.

(91) It is noted that in 2012 the Council repaid part of the aid in the amount of GBP 8.8 million. Nevertheless, since the repayment was made from the Council's own resources, i.e. from public funds, the Commission cannot consider this repayment as reducing the aid intensity. It effectively only replaced one source of public funding (the UK local authorities) by another (the Council).

(92) Thus, the aid intensity of 100% is 2.5 percentage points above the funding gap ratio, calculated based on the actual figures so far and the forecasted profits for the future. In order to ensure that the aid intensity is limited to the actual funding gap ratio, any excessive aid above the funding gap ratio has to be removed.

(93) In this connection, the UK authorities have undertaken that the Council will recover the amount of aid in excess of the funding gap ratio with due interest from the future profits of the Terminal as soon as they arise. The recovered amount will not be reinvested in the Terminal. The UK authorities have also committed that the Council will keep separate accounts for the Terminal to

ensure that such profits and amounts recovered are correctly determined, effectively applied and can be properly verified.

(94) The Commission observes that the above undertaking will ensure a separation between the costs and revenues that pertain to the Terminal from those of other possible Council activity.

(95) In the light of those commitments and since the Terminal has so far generated losses, the Commission considers that, in the present case, it is appropriate to take into account the forecasted profits of the Terminal as a source of reduction of the aid. In this context, it is noted that according to the NPV analysis the Terminal is expected to generate a discounted accumulated profit of GBP 2.9 million from 2013 onwards. Thus, the excessive aid of GBP 445,324[18] (plus interest), will be removed by depriving the Terminal of a corresponding amount of profits generated from the Terminal itself, thereby bringing the aid intensity in line with the funding gap of the project. The commitment to keep the accounts separate will ensure that the Terminal's profits and amounts recovered are correctly determined, effectively applied and can be properly verified. This will reduce the Terminal's future investment capacity and eliminate the possible distortion induced by the marginal excessive amount of State aid.

(96) In addition, based on the financial data provided by the UK authorities, the internal rate of return ("IRR") of the investment amounted to 8.2% whereas the average return on sales ("ROS") over its economic useful life period amounted to 3.1%.

(97) By 2006, when the financial analysis was carried out, the yield of the UK Government 10-year bonds (gilts) was around 4.4%. Thus, the IRR was 3.8 percentage points above the return on, what is commonly considered, a risk-free financial asset. For projects involving business risk, a rational market investor would expect additional reward above the risk-free rate to compensate for uncertainty of returns. Given the high level of uncertainty and volatility of the revenues from operation of a cruise Terminal, a risk premium of 3.8 percentage points does not appear to be excessive.

(98) In the present case, the Council only incurred the operating costs, therefore it is appropriate to give also consideration to the operating performance measure, i.e. ROS. It is noted that the average ROS was 1.3 percentage points below the risk-free rate. Considering that the operation of the Terminal involves significant business risk, such level of profitability cannot be deemed to be excessive. Both IRR and ROS values indicate that the amount of aid can be considered as limited to what was necessary to induce the Council to undertake the investment in the Terminal.

(99) In view of the above, taking into account the commitments made by the UK authorities, the aid can be assessed as proportional.

[18] 2.5% x GBP 17,812,943

4.3.3. Distortion of competition and effect on trade between Member States in light of the common interest

(100) As shown above in recitals 30 to 32, the Terminal is a relatively small player on the UK cruise market, with an estimated share in the UK turnaround market of 1.1%. The Terminal is not forecasted to grow significantly in the future. The total annual number of turnaround cruise passengers at the Terminal is forecasted to reach 13,200 in 2013, 14,000 in 2014-2016 and 20,000 subsequently. This would represent a 2.5% market share, assuming a static cruise market in the UK.

(101) However, the UK market is likely to grow. Based on the information provided by the UK authorities, between 2004 and 2012 the UK turnaround market has been growing at an average rate of 13% p.a. Moreover, the creation of an accessible and attractive UK trans-Atlantic turnaround cruising facility in Liverpool could attract additional US cruise passengers into Europe and so increase the overall market size. Furthermore, the fact that the Terminal to some extent has only replaced the capacity freed by the closure of previously existing turnaround facility in Liverpool at Langton Dock, can be considered as additional mitigating factor.

(102) The Terminal's share in the port of call segment is also low. The UK authorities estimate it at 4% of the UK market. It should be noted, however, that the distortion of competition in this segment is limited due to its nature. A decision to send a cruise vessel to the Terminal is primarily based on the market demand to visit Liverpool. Since there are no good substitutes (no other port can be Liverpool), the impact on competition is relatively smaller than in the turnaround segment. In addition, the Terminal can only accommodate one ship at a time. By adding some turnaround traffic, the Terminal may be forced to cancel some port of call visits.

(103) *A fortiori*, the restriction of competition triggered by the aid appears to be far lower in the broader EU market including ports from other Member States, with which the Terminal may also be in competition, to the limited extent to which such ports may have cruise terminals serving as possible substitutes of the Terminal.

(104) In view of the above, the positive effects of the construction of the Terminal outweigh its potential distortion of competition and trade. Therefore, the State aid granted for this investment does not affect competition and trade between Member States to an extent that would be contrary to the common interest.

4.3.4. Conclusion on the compatibility of the aid

(105) On the basis of the foregoing findings, the aid under scrutiny is necessary and proportional to address a well-defined objective of common interest and does not affect competition and trade between Member States to the extent that would be contrary to the common interest. On these grounds, the Commission concludes that the aid is compatible with the internal market pursuant to Article 107(3)(c) TFEU.

5. CONCLUSION

The Commission regrets that the United Kingdom of Great Britain and Northern Ireland put the aid for the construction of the Liverpool City Council Cruise Liner Terminal into effect, in breach of Article 108(3) of the Treaty on the Functioning of the European Union.

However, it has decided, on the basis of the foregoing assessment, to consider the aid compatible with the internal market pursuant to Article 107(3)(c) of the Treaty on the Functioning of the European Union.

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

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Yours faithfully,

For the Commission

Joaquín ALMUNIA
Vice-president