



EUROPEAN COMMISSION

Brussels, 16.V.2006

C (2006) 1855 final

**Subject: State aid No N 169/2006 – United Kingdom
Aid of a Social Character Air Services in the Highlands and Islands of
Scotland**

Madam,

I. Procedure

1. By electronic notification on 14 March 2006 the United Kingdom authorities notified to the Commission, in accordance with Article 88(3) EC Treaty of their intention to put in place an aid scheme granting aid of social character for residents of specified areas within the Highlands and Islands of Scotland in respect of air services. This notification was registered by the European Commission under number N169/06.

II. Detailed description of the measure

2. The measure which is the subject of the present decision concerns the intention of the United Kingdom authorities (the Scottish Executive) to grant an aid of a Social Character discount on eligible air services which will be available to all people (“eligible persons”) whose main residence is in one of the defined geographical areas (“eligible geographic area”) in the most peripheral parts of the Highlands and Islands of Scotland.
3. The eligible geographic areas comprise: Western Isles, Orkney Isles, Shetland Isles, Islay and Jura and Caithness including the wards of Tongue and Farr and Sutherland North West. All of the eligible areas are island communities with the exception of Caithness including the wards of Tongue and Farr and Sutherland North West which is the most remote mainland area of the UK. Students whose main home residence is within the eligible geographical areas but who are studying elsewhere will be eligible for the scheme.

The Right Hon Margaret BECKETT
Secretary of State for Foreign and Commonwealth Affairs
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Eligible Geographic Region	Population
Western Isles	26,500
Orkney Isles	19,000
Shetland Isles	22,000
Islay	3,500
Jura	200
Tongue & Farr	2,000
Sutherland NW	2,100
Caithness	25,000
Total	100,300

4. These areas have been chosen because they are extremely remote with few alternative transport choices but they are or could be served by air links to the main centres in Scotland.
5. Although not an island, the area of Caithness including the wards of Tongue and Farr and Sutherland North West has been included as it meets the criteria used for the scheme. The transport links currently available to the population include long rail or road journeys with poor options for daily return journeys. There are, however, air services that offer good services to Aberdeen and Edinburgh.
6. Other remote areas of Scotland are not included within the scheme boundary either because they are served by Public Service Obligation air services or because they are not within the catchment area of eligible air services and do not access air services through airports in those eligible areas. The scheme is aimed at the local population of the eligible geographical areas and will not apply to employees of businesses based in these areas but who live outside the area.
7. The scheme is targeted at the populations of the most remote areas of the Highlands and Islands. The choices faced by these communities when travelling to the main economic, administrative and population centres of Scotland are typically journeys of extremely long duration or expensive air services. These high fare levels (relative to other parts of the U.K. and of Europe) are a consequence of the “thinness” of typical routes in the region.
8. In the opinion of the UK authorities, the high fare levels act to increase the isolation of the communities in these remote regions by creating a barrier to social and commercial activity. The aid of a social character scheme has therefore been designed to promote social inclusion of the populations of these isolated regions.
9. The commercially viable air routes in the Highlands and Islands attract few passengers due to the lack of population and peripheral nature of the region. This leads to relatively high fares that in turn make the services unattractive for the majority of journeys undertaken by residents in these areas.

10. The aid to be granted will be granted by way of discount, the discount to be offered is a set percentage of the airline fare excluding taxes, airport charges and fuel/insurance/security surcharges etc. The discount will be the same for each eligible route and will be set at up to 50% of the normal tariff. The discount will bring fares available to residents of the eligible regions down to levels similar to those enjoyed on domestic services in the rest of Europe.
11. The budget for the scheme will be £11.2 million (€16.2 million) per annum for an initial period of 2 years. It has been estimated that a 50% reduction in fares could result in an increase of up to 40% in the journeys taken by eligible passengers. However, the increased demand will be constrained due to the types of aircraft used in the region (primarily up to 34 seats) and the seasonal nature of the demand. The estimate is therefore likely to provide an upper bound for the amount of subsidy required on current routes.
12. The scheme is designed such that an eligible person will qualify for discounts on any scheduled air service to and from any airport within the eligible geographic area to:
 - One of four main population centres within Scotland – Glasgow, Edinburgh, Aberdeen, and Inverness; and to
 - Another airport within the eligible geographic areas.

Current air services eligible for the aid				
Journey	Time¹	Fare²	Frequency³	Operator
Shetland Islands				
Sumburgh to Aberdeen	1.00	£288 (€416)	5	Loganair
Sumburgh to Inverness	1.00	£276 (€399)	1	Highland Airways
Sumburgh to Glasgow	1.30	£276 (€399)	2	Loganair
Sumburgh to Edinburgh	1.30	£318 (€460)	2	Loganair

¹ Not all journeys are direct

² Estimated price based on return short notice fare

³ Per day

Orkney Islands				
Kirkwall to Aberdeen	0.50	£252 (€364)	3	Loganair
Kirkwall to Inverness	0.45	£190 (€275)	2	Loganair
Kirkwall to Edinburgh	1.50	£316 (€457)	2	Loganair
Western Isles				
Stornoway to Glasgow	1.00	£268 (€387)	3	Loganair
Stornoway to Edinburgh	1.45	£268 (€387)	2	Loganair
Stornoway to Edinburgh	0.45	£152 (€220)	1	bmi
Stornoway to Inverness	0.30	£178 (€257)	1	Highland Airways
Stornoway to Aberdeen	1.00	£125 (€181)	1	Eastern Airways
Islay and Jura				
Islay to Glasgow	0.45	£96 (€139)	2	Loganair
Caithness				
Wick to Aberdeen	0.35	£99 (€143)	3	Eastern Airways
Wick to Edinburgh	1.10	£270 (€390)	1	Loganair

13. There will not be a restriction on the number of trips per eligible person. The discount will be available for both single and return journeys, with no restrictions on the point of origin of the passenger's itinerary.
14. The following will be excluded from the scheme:
- A journey that is part of an onward connection to an airport outside of the four population centres and the eligible geographic areas.
 - Compensated Public Service Obligation (PSO) routes.
 - People whose main residence is not in the eligible geographic area.
 - National Health Service funded trips⁴.
15. There are currently a number of air routes operated under compensated public service obligations (PSOs) which are excluded from the scheme. PSOs are applied to those routes which have no prospect of being commercial viable. The aid of a social character which is the subject of the present decision is considered by the UK authorities to be more appropriate for air services which can be provided commercially but at a cost which is a barrier to social inclusion. It allows support to be targeted at those communities which are disadvantaged by high air fares.

Compensated PSO routes in Scotland

⁴ National Health Service funded trips account for approximately 20% of total traffic on services from the peripheral regions

Routes	Subsidised by	Operator
Glasgow-Barra	Scottish Executive	Loganair
Glasgow-Campbeltown	Scottish Executive	Loganair
Glasgow-Tiree	Scottish Executive	Loganair
Stornaway-Benbecula	CNES ⁵	Highland Airways
Benbecula-Barra	CNES	Loganair
Kirkwall- Papa Westray	Orkney Islands Council	Loganair
Kirkwall- Westray	Orkney Islands Council	Loganair
Kirkwall-North Ronaldsay	Orkney Islands Council	Loganair
Kirkwall-Eday	Orkney Islands Council	Loganair
Kirkwall-Stronsay	Orkney Islands Council	Loganair
Kirkwall-Sanday	Orkney Islands Council	Loganair
Shetland mainland-Foula	Shetland Islands Council	Loganair
Lerwick-Fair Isle	Shetland Islands Council	Loganair
Sumburgh-Fair Isle	Shetland Islands Council	Loganair
Shetland mainland-Out Skerries	Shetland Islands Council	Loganair
Shetland mainland-Papa Stour	Shetland Islands Council	Loganair

16. The notified measure provides that controls will also be put in place to ensure that the scheme is only used by eligible persons. Eligible persons will have to apply to join the scheme. On application, eligible passengers will be provided with a card and an identification number that will then be required when purchasing discounted tickets under the scheme. In order to obtain a card/identification number the eligible passenger will be required to prove that their main residence is within the geographical area defined by the scheme. Proof of main residence will be in line with payment of Council Tax or, for students studying outside the eligible geographical areas, through their home location provided to the Student Award Agency for Scotland.
17. The Scottish Executive have also provided that passengers will also be required to show that they are the eligible person at the time of travel in order to avoid abuse of the system by ineligible persons. It is anticipated that photo identification will be used to verify identity. Verification will be achieved as part of the check-in or boarding process. To verify eligibility, the person travelling on a discounted ticket will be required to show an acceptable form of photo ID.
18. The initial period of registration will be to 31 March 2008, with renewal required after this period. One of the conditions of the Scheme will be that eligible persons must not use the discount in the event that the eligible geographic area ceases to be their main residence.
19. In addition a number of controls and safeguards will be put in place to remove any potential for the scheme to be exploited by either travel agents or participating carriers. Clear and robust agreements will be put in place between the carriers, travel agents and the Scottish Executive. These agreements will specify the requirements and obligations on each party participating in the scheme. The airlines will be required to demonstrate that discounted fares have

⁵ Comhairle nan Eilean Siar (Council of the Western Islands)

been offered with the same eligibility as non discounted fares and that there will be no fare increases without prior consultation with Scottish Executive.

20. The scheme will be operated through the current sales distribution channels including travel agencies and directly through the airlines' websites. There will be no discrimination related to the distribution channels in the application of the scheme. The discounts will be applied by the airline or booking agent at time of purchase. The airline or booking agent will subsequently invoice the Scottish Executive for all the discounts applied within an agreed period (at this stage it is assumed by the Scottish Executive that this will be monthly). Proof will be required:
 - That the discounts were given to eligible passengers, and
 - Of the volume of discounts issued.
21. In addition to the information required for invoicing, airlines taking part in the scheme will be required to provide information to allow the Scottish Executive to monitor the impact of the scheme. The information provided by the airline will be used to check that:
 - There is the same availability of fares given to discounted and undiscounted fares.
 - The discount provided by Scottish Executive is clearly identified and itemised in any booking transaction and recorded to ensure compliance.
 - The airline needs to demonstrate compliance with procedures that limit scheme usage to eligible passengers.

Necessity and justification of the measures

22. In the opinion of the Scottish Executive, the scheme is necessary and appropriate given the remoteness of the eligible areas. The aim of the measure is to reduce the isolation of these communities by tackling the high fare levels that create a barrier to social and commercial cohesion. The Highlands and Islands of Scotland⁶ (NUTS-level 2) is one of the remotest and least populated regions of Europe. The aid will apply to the most peripheral areas of the Highlands and Islands of Scotland.
23. In the period from 1994 to 1999, the Highlands and Islands had ERDF Objective 1 status. Following the success of the 1994-99 Objective 1 Programme, the economy of the Highlands and Islands improved such that the region is no longer eligible for Objective 1 status. However, in recognition of the difficulties faced by this large, peripheral area, a special transitional programme was put in place from 2000 to 2006. From 2007 to 2013 the region will receive phasing-out convergence funding. Phasing out support is intended to consolidate what has been achieved through Objective 1 status.
24. The “phasing out” status granted to the Highlands and Islands for the period from 2007 to 2013 recognises that much remains to be done in the region to strengthen fragile local economies⁷. The programme will address the particular problems of low GDP and extreme peripherality.

⁶ European Structural Funds in the United Kingdom (2000-2006), February 2004

⁷ Directorate General for Regional Policy: Cohesion policy: the 2007 watershed Legislative proposals by the European Commission for the reform of cohesion policy (2007-13 period)

III. Assessment of the notified measures

Existence of aid

25. By virtue of Article 87(1) of the EC Treaty “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.”
26. The criteria laid down in Article 87(1) are cumulative. Therefore, in order to determine whether the notified measures constitute State aid within the meaning of Article 87(1) of the Treaty 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,
 - distort or threatens to distort competition, and
 - affects trade between Member States.
27. The concept of State aid applies to any advantage granted directly or indirectly, financed out of State resources, granted by the State itself or by any intermediary body acting by virtue of powers conferred on it. In this context the decision of the Scottish Executive to fund this scheme constitutes a grant of State resources.
28. In the present case the public funding is not a general measure as it is directed at a particular group being the population of peripheral areas of the Highlands and Islands of Scotland. Furthermore, the financial compensation is likely to favour the operation of air services within the Highlands and Islands of Scotland by generating additional demand for tickets. It will therefore indirectly benefit those companies providing eligible air transport services to/from the eligible area.
29. This increased demand is capable of having an effect on inter-state trade taking into account the inherent international character of intra-Community air transport, this is all the more the case since the entry into force of the so-called “third liberalisation package”⁸ liberalising air-transport services throughout the Community on 1 January 2003. Finally the financing measure distorts or threatens to distort competition as it indirectly benefits only those operators providing regular scheduled services on the eligible routes.
30. Therefore as the measure involves public financing, directed (albeit indirectly) at certain beneficiaries and indirectly at certain undertakings engaged in an economic activity affecting trade between Member States and as it may distort or threaten to distort competition inside this market it may fall to be considered a State aid within the meaning of Article 87(1) of the EC Treaty.

Legal basis for appraisal

31. It is therefore necessary to examine this measure in the light of Articles 87 of the EC Treaty. In this regard it should be noted that it is the contention of the U.K. authorities that this ‘aid of a social character’ measure is in line with the common

⁸ OJ L240/1 of 24.8.1992

market having regard to the provisions of Article 87(2)(a) of the EC Treaty which provides that “aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned” shall be compatible with the common market.

32. The Commission’s Communication on State aids in the air transport sector⁹ provides that, in the case of direct aid for the operation of air services and the application of Article 87(2)(a):
- The aid must effectively be for the benefit of final consumers.
 - The aid must have a social character, that is, it must, in principle, only cover certain categories of passengers travelling on a route such as children, handicapped people, people with low incomes, etc. However, in the case where the route concerned links an underprivileged region, the aid could cover the entire population of this region.
 - The aid must be granted without discrimination as to the origin of the services, that is to say whatever EEA air carriers operate the service. This also implies the absence of any barrier to entry on the route concerned for all Community air carriers.
33. In the scheme under examination, the Commission finds that the financial compensation is for the benefit of final consumers. The air carriers that operate the routes in question will act as intermediaries and will be reimbursed by the competent authority, the Scottish Executive, on production of proof of sale, in an amount equal to the financial benefit which they will have effectively granted to each of the eligible passengers.
34. The Commission can also conclude that the benefit to be granted has a social character because it is reserved for a particular category of passenger whose particular situation justifies the payment of aid for social reasons. The scheme is designed to benefit persons whose principal residence is in the eligible areas of the Highlands and Islands of Scotland.
35. The residents of the peripheral regions of the Highlands and Islands of Scotland face either a cost barrier of high fares or the prospect of very long journeys to reach the economic and administrative centres of Scotland. It is established Commission practice in this regard as set out in the previously mentioned Commission Communication as well as in a number of decisions concerning similar schemes¹⁰ that residence in a remote region may be regarded as a social handicap which justifies the grant of such individual aid.

⁹ Commission Communication 94/C 350/07 on the application of articles 92 and 93 of the Treaty in the aviation sector, OJ C 350 of 10.12.1994, p.5.

¹⁰ Decision N386/1998 of 29 July 1998 concerning links between the Balearics and the rest of Spain, Decision N387/1998 of 29 July 1998 concerning links between the Canaries and the rest of Spain, Decision N414/1998 of 27 August 1998 concerning links between Madeira and the rest of Portugal, Decision N399/1998 of 3 September 1999 concerning support for air links in favour of the residents of the minor islands of Sicily, Linosa, Lampedusa and Pantelleria, Decision N26/2003 of 5 March 2003 concerning links between Paris and Corsica, Decision N24/2000 of 3 March 2000 concerning links between Marseille, Nice and Corsica, and Decisions N638/2000 and N639/2000 of 5 October 2000 concerning links between Lyon, Montpellier and Corsica, Decision N385/2004 of 20 October 2004 concerning aid of a social character for certain categories of passenger on air services between

36. Finally, the Commission finds that the notified measure is open without discrimination to all Community air carriers that wish to provide air services on all or part of the eligible routes. In this respect, the scheme will operate in accordance with the provisions of Article 3 (2) &(4) of Regulation 2408/92 which provides that the operation of air routes within the territory of individual Member States is entirely open to free competition among all Community air carriers.
37. Consequently the Commission concludes that all the conditions set out in Article 87(2)(a) of the EC Treaty have been complied with by the notified measure.

Decision

The European Commission has therefore decided not to raise any objections to the measure in question on the grounds that the aid is compatible with the Common Market.

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Yours faithfully,
For the Commission

Jacques Barrot
Vice-president of the Commission