

# Scottish Ferry Policy

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## 1. Introduction

The purpose of this paper is to review the evolution of Scottish policy for the provision of ferry services 1999-2009, a period broadly coinciding with the life of the re-established Scottish parliament. We shall argue that, despite clear and consistent warnings by this author and others, the government failed to put in place measures and safeguards that were regarded as standard practice for such an industry providing essential services. These failures in economic regulation in the first Session of Parliament (1999-2003) in turn had knock-on implications for potential breaches of EC State aid and competition law. The second (2003-2007 and third (2007-continuing) Sessions added further new problems in terms of potential compliance with EC State aid and competition law. We suggest reasons for the emergence and persistence of these problems and also identify possible solutions.

Most ferry operations in Scotland are provided by two State-owned companies, CalMac Ferries and NorthLink. CalMac Ferries recently won a six year contract to provide Clyde and Hebrides ferry services. The contract to provide the Northern Isles (Orkney and Shetland to Mainland services) was the subject of re-tendering in 2006. In 2008, the Scottish Government initiated a pilot study to test a Road Equivalent Tariff (RET) fares system for Scotland's ferry services. Then in May 2008, the European Commission announced<sup>1</sup> it was to investigate payments of subsidies to CalMac and Northlink

As far as the current policy is concerned, the Scottish Parliament Information Centre (SPICe) recently produced a briefing paper on ferry services in Scotland and noted;

The Scottish Government has never produced a separate ferry strategy document. However, the National Transport Strategy (Scottish Executive 2006) does briefly mention lifeline ferry services, stating: "*Once the tendering of the Clyde and Hebrides ferry service has been completed in 2007 we will undertake a comprehensive review of lifeline ferry services to develop a long-term strategy for lifeline services to 2025. The review will include a detailed appraisal of routes to determine whether a better configuration could be developed in response to calls for new and faster*

*connections serving these isolated communities and a review of fares structures as part of a broader review of the affordability of public transport*"<sup>2</sup>.

That Terms of Reference of that Review have recently been announced and we deal with it later in this paper.

We shall use the term "Executive Branch" to refer to those Scottish Office / Scottish Executive / Scottish Government officials and ministers who have held responsibilities individually and collectively for formulating and implementing ferry policy here down the years. Similarly, we shall use the generic term "Transport Committee" to refer to the Scottish Parliament's committee with responsibility for ferry services, the name and remit of the relevant transport committee has changed over all three sessions of the new parliament.

## 2. Scottish Parliament Session 1: May 1999 - May 2003

Before the new (or reconstituted) Scottish Parliament was a year old, the Executive Branch published "*Delivering Lifeline Ferry Services, Meeting European Union Requirements: a Consultation Paper*"<sup>3</sup> in April 2000. Reading it now in the light of subsequent developments in terms of EC policy and law here (and the Executive Branch's interpretation of that policy and law), it actually provides a clear and succinct view of the economic and legal issues facing policy makers in the context of what they could reasonably be expected to know and advise at the time in terms of policy options. The consultation paper announced with respect to a possible legislative agenda;

*The existing legislation under which subsidies are provided to Caledonian MacBrayne ... predates the UK's accession to the European Union and may require some amendment. Ministers take the view that any new legislation can be prepared to a longer timescale as domestic legislation does not preclude the Executive complying with the State aids rules. Nevertheless, Ministers believe there could be advantage in reviewing the legislation in the longer term. Whilst it would not, in any case, be possible to have new provisions in place for the first tender exercise, for subsequent exercises new legislation might be introduced to set the framework for:*

- *the requirement to tender services in respect of PSOs;*
- *powers to grant exclusive rights to routes in certain circumstances (to rule out "cherry-picking" in the peak tourist season in a way which might undermine the overall viability of a route); and*

- *setting out appropriate roles in respect of a possible Highlands and Islands authority, local authorities and others.*<sup>4</sup>

Before considering the fuller implications of this agenda, it is important to clarify the respective roles and potential contribution of PSOs (public service obligations) and PSCs (public service contracts) under EC law in this process especially since contingent issues assume even greater significance in later years. The relevant EC laws and guidelines here are contained in a variety of forms; regulations, cases and communications of various kinds, and I have collected extracts from some seminal or indicative documents in a single collation<sup>5</sup>, each of whose extracts deals with some or other aspect of PSOs in this context. Three points merit emphasis.

First, the respective roles of PSOs and PSCs in this context were set out in the EC's 1992 Maritime Cabotage Regulation<sup>5</sup> which made clear that a PSC could be concluded *"in order to provide the public with adequate transport services" specifying such issues as "continuity, regularity, capacity and quality"*. *On the other hand, a PSO was defined as "obligations which the Community shipowner in question, if he were considering his own commercial interest, would not assume or would not assume to the same extent or under the same conditions". PSOs were "limited to requirements concerning ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessel"*. The Commission recognised that it would not constitute State aid if the shipowner was awarded appropriate compensation (subsidy) for carrying out such PSOs, providing any compensation for PSOs *"must be available to all Community shipowners"*.

In short, much like a knife and fork, both PSCs and PSOs are alternative tools or instruments designed for different economic and legal purposes. If you want to maintain an adequate and reliable service, you use a PSC. If you want to compensate (subsidise) an operator or operators for carrying out socially desirable (though commercially unprofitable) services, you use a PSO.

Second, there may be cases (in some circumstances, the norm) where a government would wish to ensure that services were both reliably provided and compensated appropriately with subsidy. This was acknowledged by the European Court in 2001 in the Analir case which recognised that that: *"even after public service obligations have been imposed on the shipowners ... complementary services could be provided by concluding a public service contract."*<sup>7</sup> In short, you could use these two tools separately and for different purposes, or you could use them together in complementary fashion to pursue a particular task – again,

much as a knife and fork can be used independently of each other, or in complementary fashion to eat a meal.

Third, are defined public service obligations required in order to subsidise EC ferry services and ensure compliance with the Maritime Cabotage Regulation and EC state aid law? This was the question asked by an MEP of the Commission in 2006 and the answer was unequivocal: *"These obligations may be imposed by regulation or, if this does not suffice to meet essential transport needs in an adequate manner, laid down by way of public service contracts. If necessary, financial compensation may be granted to operators to cover the costs involved in meeting public service obligations. The imposition of public service obligations is therefore a precondition for any compensation being given"*.<sup>8</sup>

In short, while there are various methods by which PSOs can be imposed (including concurrently and in complementary fashion with PSCs as the Analir case above implied), the imposition of clearly defined PSOs is a precondition for any compensation if such subsidy is not to run the danger of being treated as illegal State aid.

That PSOs are different instruments for PSCs; that you can use PSCs and PSOs separately or together; and that you must have a clearly defined PSO if you wish to subsidise ferry operations under Maritime Cabotage and State aid law; all these were (and are) well-established and accepted principles following from EC law. Not only are they law, from an economics perspective, they are also common sense; a PSC can be a complex and detailed instrument and if you do not clearly and separately define what is the PSO (even if it is being delivered with the help of a PSC) then it can be difficult to isolate and disentangle the part of the contract that is being (legitimately) subsidised from that part which could be a purely commercial activity. None of this would have been regarded as a matter of controversy in the first Session of the Scottish Parliament, but as we shall see it has become very much a major issue in recent years.

Returning to the legislative agenda sketched out above in *"Delivering Lifeline Ferry Services"*, it could be said to have been both appropriate and proportionate. It included provision for PSOs embodied in legislation; measures to deal with cherry picking and the issue of exclusivity; and consideration of the possible roles that an "authority" could take here, this opening up the possibility of provision for oversight by an independent Regulator as was common practice in other industries providing essential services and subject to competitive tendering.<sup>9</sup>

The problem was that none of this ever happened. The Consultation Paper said that all this should be deferred until after the first tender exercise, which was very much a matter of putting the cart before the horse. If the rules of the game

are not drawn up until after the game is played, then it is not surprising if players and referees are confused about what does and does not constitute a legitimate strategy. The reason given for the deferment in the first place was timing. The Executive stated they were “aiming to have the first tender in place by Spring 2001 with implementation to follow”<sup>10</sup>, in short, in about a year from the public announcement of the intention to consult the public on the matter. However, as I argued in 2001 in two submissions to the first Parliamentary Inquiry<sup>11</sup>, even then such timing was hopelessly optimistic. But this deferment did have the effect of helping pre-empt serious debate on what the statutory and policy frameworks could and should look like here.

It must be noted that the Executive Branch could reasonably claim genuine achievements in this context over this period. First, it argued and sustained the case for maintenance of the bundling of routes as represented by the CalMac network through to the first tendering of these routes (though it should be noted that the Commission has raised questions in its current investigation as to whether the Executive Branch’s actual bundling of routes here has led to potential State aid issues<sup>12</sup>). Second, the original 1992 Maritime Cabotage Regulation<sup>13</sup> made no provision for estuary or peninsular services to be compensated for (subsidised) under EC law; pressure from the Executive Branch and Professor Neil McCormick MEP led to the Commission recognising in new guidelines<sup>14</sup> in 2003 that estuary/peninsular services that fulfilled certain geographical criteria could be treated as islands for such purposes. Third, it arranged for CalMac’s vessel and shore-based infrastructure to be allocated to a VesCo or an asset owning company, later to be named Caledonian Maritime Assets Ltd (CMAL), with actual ferry operations to be carried out through competitive tendering of routes under 5-year (later 6-year) contracts. Since the relevant legislation made provision for possible subsidy of route operations through PSOs but not subsidy of investment in vessel construction, such separation made it easier to ring fence subsidy to operations only, and, as importantly, made it easier in principle to demonstrate to the European Commission that such ring fencing had taken place.

However, a consequence of the absence of a clear statutory framework for the new regime which was to be put in place was that the problem was not properly defined and structured. It was seen narrowly as one of contract writing and adaptation of an existing transport service to comply with (what were to the Executive Branch) new EC rules. The problem should have been clearly defined in the first instance as one of the introduction of competitive tendering for a de-nationalised industry providing essential services. Had the problem been properly defined, then policymakers could have drawn on the considerable body of knowledge and experience of how to deal with such problems in other formerly nationalised UK industries that also provided

essential services. If that had been done then, as I strongly argued in evidence<sup>15</sup> in 2001 to the first Parliamentary Inquiry into the tendering of CalMac, policy makers would see from previous cases that what was needed was: (a) an independent regulator (b) a clearly defined Operator of Last Resort (OLR) and (c) a well developed supporting statutory framework.

Had the problem been properly defined, policy makers would have been more likely to have anticipated and dealt with issues contingent on what would have to be radically transformed roles and functions of economic actors and policy makers in such circumstances. For example, when the need for this process became public in 2000, the “CalMac” Clyde and Hebridean ferry services were run by a nationalised industry which could buy and sell its own vessels and had a planning horizon that in principle could encompass the life of these vessels, 20 years or more. Today, the “CalMac” Clyde and Hebridean ferry services are run by an operating company that owns none of the vessels or linkspans it uses and whose planning horizon (and existence) is limited by a public sector contract which is constrained to 6 years under EC law. One side effect of the ad hoc manner in which the subsequent process was handled was confusion over who is and who should be responsible for the long term strategy formulating role and functions that were previously the responsibility of CalMac in its capacity as a nationalised industry.

But perhaps the most serious set of errors to flow from the misspecification of the problem was that it gave a false impression of what competences and capabilities were necessary to deal with it. As long as this was regarded as just another transport problem, the Executive Branch could be regarded as having an abundance of inhouse resources that could be allocated to deal with it. But specifying the problem properly makes it clear that, in the UK, the competences and capabilities to deal with the introduction of competitive tendering for a de-nationalised industry providing essential services (such as gas, electricity, telecommunications, rail), lay not in Scotland but in the UK regulatory agencies and Whitehall. The Executive Branch, certainly those responsible for transport, could not in all fairness be regarded, then or now, as having significant direct experience of these matters.

Part of the reasons for the misspecification of the problem may well have been political. There had been attempts to privatise CalMac during the term of the Thatcher government which had encountered fierce public opposition. Even though the Minister responsible told the Scottish Parliament in November 2000 that “*I am happy to assure members that we have no plans to privatise CalMac*”<sup>16</sup> the introduction of the EC competitive tendering dimension was seen by some

as an attempt to “privatise CalMac by the back door”<sup>17</sup> and led to considerable debate inside and outside of Parliament.

It was true that CalMac was not to be privatised, though its status as nationalised company was to be revoked and it was eventually broken up into constituent State-owned parts. In October 2006, ownership of the CalMac’s vessel and harbour assets was separated out from the associated ferry operations and the operations were transferred to a new operating company within the David MacBrayne Group, CalMac Ferries Ltd. A separate State-owned company, Cowal Ferries Ltd, took over responsibility for CalMac’s Gourock-Dunoon operations. Caledonian MacBrayne Ltd. retained ownership of these vessel and harbour assets and was renamed Caledonian Maritime Assets Ltd. (CMAL). In July 2006, operation of the Northern Isles ferry services had been transferred to NorthLink Ferries Ltd. from the predecessor operator. The David MacBrayne Group became the State-owned holding company for the operators CalMac Ferries Ltd, Cowal Ferries Ltd, Northlink Ferries Ltd, and Rathlin Ferries Ld (the latter in Northern Ireland).<sup>18</sup>

Given that the introduction of competitive tendering and de-nationalisation for industries providing essential services in the UK had typically been through outright privatisation, any attempts to apply direct comparisons, capabilities and experience from these previous exercises to the CalMac case could have run the danger of providing ammunition to those who suspected and claimed that the exercise had a hidden agenda, irrespective of whether or not that was the case.

Whether or not ultra-sensitivity on the part of the Executive Branch to charges of “back-doors privatization” contributed to the failure of the Executive Branch to properly specify the problem, the reality was that officials in the Executive Branch handled a major policy problem area with which there was no reason to believe they could have direct experience and familiarity, and with little evidence of learning lessons that could have been drawn from obvious and available comparators from UK regulated sectors.

One area where this self-imposed myopia had an almost immediate effect was with respect to the apparently arcane (but absolutely crucial) issue of Operator of Last Resort (OLR). Essential services subject to competitive tendering in regulated sectors such as in the UK generally stipulate there should be a *pre-designated and qualified operator* ready to take over a tender immediately in the event of an incumbent’s failure (whether for technical, financial or any other reasons). This is not something that is really needed in the case of nationalised industries (as CalMac was at the start of this exercise). Nor is it a matter which tends to greatly exercise the European Commission. This is a provision where principles of subsidiarity tend to come into play with it

generally left as a matter for national governments or their devolved authorities to deal with.

Nor is the question of OLR something that tends to be raised on a day to day basis for anyone looking at current issues affecting regulated sectors. It is rarely called on, which to a large extent is part of the intention behind it. An analogy can be drawn with the rule in tennis that a fault is called if a player “*deliberately touches (the ball) with the racket more than once*”.<sup>19</sup> Once you have the rule, there is little chance of it being called on. But if you do not have the rule then you would have a very different game indeed. OLR is a safety net for the case of unexpected technical or financial failure which may befall even a well-intentioned operator. However, it is also a guard against moral hazard and the dangers of a tenderer using a weak or loose contract to misrepresent their true intentions or situation, and renegotiate in the course of the contract in the knowledge that the contract awarding authorities have little alternative but to accept their new terms for continued provision of an essential service.

Ironically, the issue of OLR need not have become a major issue had the Executive Branch adopted a proposal they set out in their original Consultation Paper in 2000 to split CalMac into a small number of route bundles and tender the bundles separately from each other.<sup>20</sup> Had this been done, the Executive Branch could have considered the option of inserting a clause into each tender that required winning tenders to act as OLR for another tender, if called upon to do so, with provision made for appropriate compensation to be made in such circumstances. There was no reason in principle why OLR responsibilities could not encompass both CalMac and Northern Isles operations. Solutions of this nature had been well tried and tested for competitive tendering regimes in other industries providing essential services. But once it was decided to tender CalMac operations as a single bundle, this option was effectively precluded. With the self-imposed myopia that arose from failing to clearly define the problem as discussed above, not only was there failure to appreciate the opportunity for OLR solutions when they arose, it led to unintended consequences being overlooked when the parameters of the problem was changed.

We emphasise that does not mean that CalMac operations should have been broken up (indeed as we were to argue later in 2005, the Altmark case suggested that there was perhaps no need to tender its operations in the first place). As was argued at the time, there are network benefits from maintaining its route operations in a concentrated bundle. But what was a serious issue then and now was how failure to recognize such issues and bring them directly and openly on to the policy agenda created potentially adverse consequences.

The potential significance of the OLR issue is illustrated with the case of the Commission announcement<sup>21</sup> in May 2008 of their intention to investigate CalMac and Northlink subsidies. The announcement notes that in the summer of 2003, a few months after starting operations, NorthLink informed the Scottish Executive that it could no longer realistically deliver its contractual obligations over the four years remaining of the contract period<sup>22</sup>. The Scottish Executive concluded Northlink was heading for insolvency and unless additional subsidy was paid, lifeline services could have been interrupted<sup>23</sup>. Significant additional subsidy of about £43mill was duly paid<sup>24</sup> and retendering eventually took place. The Commission Announcement<sup>25</sup> here notes that “*According to the UK authorities, in preparing its bids, NorthLink assumed that it would also enjoy a monopoly on the ro-ro traffic ... This assumption proved however incorrect*”. It could be added that the UK authorities also assumed at the initial tender award stage that Northlink would not threaten to withdraw from the route unless they were provided with more subsidy. That assumption also proved incorrect. The Commission’s provisional conclusion which the current Inquiry is investigating is that as far as the emergency additional subsidies paid to Northlink are concerned, “*the payments in question likely constitute State aid*”<sup>26</sup>. Some points are worth emphasising regarding this series of events.

First, despite the fact that there had been many tenders and franchises in the UK transport sector over many years, what happened in the Northlink case was remarkable and unusual and indeed forced retendering of transport operations<sup>27</sup> has been a relatively rare event.

Second, there should have been no basis for excusing Northlink’s “incorrect” assumption that it “would...enjoy a monopoly”. As noted above, the *Delivering Lifeline Ferry Services* consultation paper in 2000 noted that one of the areas that should be looked at in future was “*powers to grant exclusive rights to routes in certain circumstances*”. Had that been done, and the conclusions spelled out (whether to award, or not award, exclusive rights), then it would have removed any confusion or ambiguity regarding monopoly rights. If exclusivity was *not* to be granted, then the tenderer would bear the commercial risks that might accrue from any market entry in the course of the tender. On the other hand, if exclusivity was to be granted, then it would be the responsibility of the Executive Branch to ensure that the legitimate interests of the tenderer did not suffer from illegitimate market entry. It was failure to properly specify property rights over market operation that helped contribute to the subsequent problems in contract execution.

Third, having properly established rights, risks and responsibilities in this case, if the operator could be seen as being unable or unwilling to deliver on promised performance

for reasons which were seen as its responsibility, then in the final reckoning the Executive Branch should have been in a position to trigger the OLR option and replace the tenderer (as happened in the case in the Connex rail franchise in the South of England in the same year, 2003).<sup>28</sup>

Fourth, we see no reason why similar circumstances could not re-occur with the resulting collapse of all or part of a tender since there has been no meaningful substantive changes in these respects to the regulatory framework that still underlies such tenders in the Scottish context.

Fifth, and crucially, even though (as we have noted) the question of whether or not to have a clearly defined OLR was not something that tended to automatically raise issues of EC law and attract the interest of the European Commission, failure to deal adequately with the OLR issue directly limited the options available to the Executive Branch when the first Northlink tender threatened default. In turn, regulatory failure here (and the Hobson’s Choice of a subsidy-fuelled bail-out by the Executive Branch) led to possible State aid failures under EC law. In other words, it was not sufficient for the Executive Branch to make every effort to be complying with the letter and spirit of EC law in this context, its failure from the beginning to deal adequately with the routine administrative nuts and bolts contingent on the introduction of competitive tendering into a denationalized industry providing essential services had knock-on implications for its potential ability to comply with EC law.

Along with Professor Tony Prosser and Captain Sandy Ferguson, I had warned in evidence<sup>29</sup> to the Scottish Parliament’s first Inquiry into ferries in 2001 about the potential regulatory failings and omissions in the context of the proposed tenders, particularly with respect to the absence of an independent Regulator and clearly defined OLR. In their Report<sup>30</sup> to the Committee, the committee’s reporters noted my specific warning that “*the (Northern Isles) contract is not yet operational, so the regime has yet to be proven effective in practice*”.<sup>31</sup> In the second Inquiry into Scottish ferry services in 2005, an MSP asked the Minister who was giving evidence to the committee: “*Do you accept that the evidence that Neil Kay gave to the Transport and the Environment Committee back in 2001 about the tendering exercise for the northern isles (Northlink) contract has—unfortunately—proved relevant, given the disastrous collapse of that tender?*” The Minister replied that there were “*lessons to learn*” from that exercise, but did not expand on what he thought they were.<sup>32</sup>

All this is without prejudice to the question of whether or not the additional payments to Northlink constituted illegal State aid, which is a separate matter for the Commission and possibly the courts to decide. Our concern here is not with these subsequent payments as such, but solely with the

events which led up to them, and the point is that had the Executive Branch followed proper and well-established regulatory systems and procedures, there should have been no significant risk here of being hostage to the misfortunes that subsequently befell them (and the public interest) in the Northlink case. Nor is there to the best of our knowledge any suggestion or evidence that Northlink was indulging in moral hazard here, and we are not suggesting that was a factor. The point is that vulnerability to such behaviour remains a structural flaw which can infect all such contracts given the weakness of the current regulatory regime.

I had noted in evidence to the Scottish Parliament in 2001, *“if the public interest is subsequently damaged because issues such as regulatory control and SOLR (Operator of Last Resort) have been neglected, this will be the Executive’s responsibility, not the EU’s”*.<sup>33</sup> The Northlink case may be taken as an early example of the consequences of such neglect. The Commission investigation may consider here from a legal perspective what the Executive Branch actually did (in terms of additional unplanned subsidy payments), whereas from a regulatory economics perspective the source of these problems is actually to be found earlier in what the Executive Branch did not do.

I provided a fuller analysis<sup>34</sup> of the OLR issue as an appendix to my submission to the second Transport Committee Inquiry into ferry services in 2005 with an update<sup>35</sup> in 2006. Despite the lessons that should have been learned from the Northlink fiasco, the Executive Branch has not acknowledged, at least in public, that this continues to be an unresolved issue with serious public interest concerns

As for the question of an independent Regulator, in 2003, the Commission advised that for ferry tenders; *“In principle, an independent authority should be responsible for the whole procedure. However, the Commission recognises that, in some cases, it might be sufficient for only the final part of the procedure (evaluation of the bids and adoption of the final decision) to be entrusted to an independent body.”*<sup>36</sup>

Whether we describe the agency responsible as an independent Regulator, an independent authority, or an independent body, the Commission’s view on how this process should be governed is consistent with the arguments put forward by Professor Prosser and me to Transport Committee<sup>37</sup> and the Executive Branch in 2001. In ignoring or rejecting these arguments, the Executive not only rejected what was recognised good practice for essential services subject to competitive tendering, it should have been clear to the Executive Branch (by 2003 at the latest) that they were also rejecting what the European Commission regarded as an important minimal requirement for compliance with EC law here. I once again made the arguments for an Independent Regulator in 2005 to the second Transport

Committee Inquiry into ferries, the Executive Branch once again noted my arguments, and once again they failed to act on them.<sup>38</sup> In July 2006, I wrote<sup>39</sup> to the Minister drawing attention *inter alia* to the Commission instructions that an “independent authority/body” should be appointed to deal with the ferry tendering process but did not receive a satisfactory reply.

### 3. Scottish Parliament Sessions 2 and 3: May 2003 – Present Day

The second Session of the Scottish Parliament May 2003 to May 2007 was characterized by the re-formation of an Executive Branch coalition of Labour and Liberal Democrats. The most visible sign of change in terms of governance was that responsibility for ferry services had been in the hands of Labour ministers during the first session, and this now switched to Liberal Democratic responsibility for the whole of the second session. It is not known whether this had any direct or indirect impact on government policy. The election of an SNP government in May 2007 created an even more visible change in governance, though as we shall see its approach to EC law largely reflected changes that had taken place in the second Session; however, there were some substantive policy changes such as the introduction of a pilot Road Equivalent Tariff (RET) Scheme which we discuss briefly below.

However, soon after the start of the second Session, there was a major development in the interpretation of EC law as it pertained to such services. On 24 July 2003, the European Court of Justice in the Altmark case<sup>40</sup> ruled that providing compensation is no more than is necessary to carry out clearly defined, transparently and objectively established public service obligations to enterprises entrusted with these obligations, such compensation did not constitute State aid.<sup>41</sup>

Some of this built on established EU case law, but one aspect which did add new elements to the public debate was that the European Court now appeared to make provision for choice of operator of a PSO service not necessarily having to be chosen by open tender. The European Court had noted that where the undertaking was not chosen in a public procurement procedure, the level of compensation should be determined by a comparison with an analysis of the costs that a typical transport undertaking would incur (taking into account the receipts and a reasonable profit from discharging the obligations).

There has been considerable debate over the meaning, relevance and significance of the Altmark judgment, much of which goes beyond the scope of this paper. For the purposes of the live debate over policy that existed at the time, what Altmark appeared to offer was the possibility of alternatives to competitive tendering, a process which had been criticised from a variety of perspectives ranging from

the potential expense of such an exercise to alleged backdoors privatization.

It was in this context that the Scottish Parliament's Transport Committee set up a second inquiry into the proposed tendering of CalMac and invited two other academics (Jeannette Findlay of Glasgow University and Paul Bennett of Edinburgh University) and me to give written and oral evidence on the issues. The then Minister gave assurances in evidence to Transport Committee that we would be consulted on these issues;

*If they are willing, we will make contact with (Findlay, Bennett and Kay) who obviously have worked so hard on these complicated issues over the past weeks and months. We will try to get clarification from them where that is important.*<sup>42</sup>

That never happened. Instead, on 12<sup>th</sup> September 2005, just two days before the scheduled debate in the Scottish Parliament on the proposed tendering of CalMac, the Executive Branch published a series of documents on the issues, including what could only be described as, in part, systematic attempts to discredit the evidence by Bennett, Findlay and me.<sup>43</sup> There was no warning that this was to be done, no opportunity to discuss or rebut what were in many cases misleading or incomplete statements and criticism of these works. The debate in Parliament<sup>44</sup> took place on the 14<sup>th</sup> September 2005 and the point was made strongly in the debate that our evidence had not been treated fairly and we had not been given the (promised) opportunity to speak for ourselves and refute misunderstandings or misrepresentations. To make matters worse, the debate added further serious misrepresentation with arguments that my proposal would lead to route-by-route tendering, a totally spurious allegation without foundation which I had refuted in direct evidence to the Scottish Executive own Consultation on the issue some months earlier.<sup>45</sup>

I have no hesitation in stating that Parliament was misled in that debate (which decided to agree to the Executive Branch's proposal to tender CalMac). Why that should have taken place, and who was responsible, is best left for others to judge. One of the most seriously misleading issues was when the Executive Branch started its analysis of "*Professor Kay's 5 part proposal which he suggests would meet the 4 Altmark criteria*" with the bald statement that "*the Altmark criteria are not applicable to ferry services which fall within the scope of the Maritime Cabotage Regulation*".<sup>46</sup>

That was what Parliament was told in September 2005. Since then the European Commission has made it abundantly clear that not only were the Altmark criteria "applicable" to such ferry services, adherence to the Altmark criteria is essential if such services are not to run the danger

of being vulnerable to charges of illegal State aid.<sup>47</sup> But of all the statements by the Commission the most serious is the announcement<sup>48</sup> in 2008 of the intention to investigate the possibility of illegal subsidies to CalMac and Northlink by the Executive Branch. Indeed, much of the announcement is largely reducible to two inter-related issues; the apparent failure of the Executive Branch to apply the Altmark criteria to these ferry services, and the linked issue of their apparent failure to apply clearly defined public service obligations to ferry services which were to be compensated with public subsidy. As the Commission had clearly warned in 2006;

*The imposition of public service obligations is therefore a precondition for any compensation (for EC ferry services) being given ... Such compensation does not constitute State aid if it complies with the criteria laid down by the Court of Justice in its judgment in Altmark.*<sup>49</sup>

In short, in rejecting the relevance of Altmark and attempting to discredit the academic proposals based around Altmark, not only was the Executive Branch case against alternatives to tendering CalMac based on totally false premises, even worse any proposals they actually implemented ran the danger of falling foul of EC State aid law. If you do not understand what the rules are, then it obviously increases the chances of breaching them, even if inadvertently and in good faith. Ignorance is no excuse under the law, especially when the law has been set out clearly and consistently, and you still choose to ignore it.

These points hold forcibly in the case of the issue of the role of public service obligations (PSOs) in EC ferry services. The new Session May 2003 – May 2007 had coincided with a significant switch in policy with respect to PSOs, though one which was not to become publicly apparent for several months. Right up until the dissolution of the Scottish Parliament at the end of the first Session in May 2003, the Executive Branch had made consistently clear the need for clearly defined and justified PSOs for subsidized ferry services under their jurisdiction. The last reference I can trace to any stated intention by the Executive Branch to award PSOs for any ferry service was a News Release<sup>50</sup>, 20<sup>th</sup> March 2003. The following week, Parliament was dissolved.

Such references by the Executive Branch ceased once the new Session of the parliament was underway, but much as in the Sherlock Holmes case<sup>51</sup> of the dog that did not bark, the lack of references to PSOs only became apparent when sometime later attention was drawn to them. Following questions in the Scottish Parliament, the Executive Branch stated in 13<sup>th</sup> June 2006:

*The Executive is tendering on the basis of Public Services Contracts (PSCs). The Executive considers that a single PSC for the Gourock-Dunoon ferry service and another single PSC for the rest of the network offer the certainty and security of a set service specification that will be welcomed by Cowal residents, residents served by the rest of the network and all other users of the ferry services. Public Service Obligations (PSOs) would not provide that certainty and security of service nor deliver on the Executive's key policy objectives. Consequently there is no need to consider, nor do we intend to consider, issues arising in relation to PSOs.<sup>50</sup>*

Two years later (June 2008) during the third Session of the Scottish Parliament), the Executive Branch stated in evidence to the Transport Committee of the Scottish Parliament<sup>53</sup>,

*"Creating a formal public service obligation in relation to ferries can be done by Westminster but not by us. Of course, a PSO merely protects the route's infrastructure; it in no way provides for there actually being a ferry service, because of the different definition of PSO in the maritime world compared with the aviation world ... a PSC enables us to specify all the things that we could do with a PSO"*

It has to be said that the position of the Executive Branch in repudiating the use of PSOs in this context is bizarre, and from the point of view of what is publicly known at this stage, inexplicable.

First, the statement that the Executive Branch cannot award PSOs contradicts what the Executive Branch had stated in 2006; *"The Scottish Executive also has powers to designate particular routes as Public Service Obligations (PSO)"* and *"the Scottish Executive retains control of the planning system and PSO designation which both affect ports, harbours and ferry routes"*<sup>54</sup>.

Second, on the question of a PSO supposedly protecting the route's infrastructure and not services, Olivier Chassagne, an official with EC's Transport Directorate noted (consistent with the 1992 Maritime Cabotage Regulation) that; *"for maritime transport, PSOs can contain requirements only in relation to the 'ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessel' (p. 410).<sup>55</sup>* Clearly, PSOs here are about operational matters and services, not infrastructure. When the Executive Branch stated later in the same evidence, *"in the maritime context, PSOs are about infrastructure; unlike in aviation, they are not about the provision of services"*<sup>56</sup>, they were plainly wrong.

Third, as for the supposed different definitions of PSO in maritime and aviation worlds cited by the Executive Branch, Chassagne notes; *"In all transport modes, the concept of PSOs is quasi-identical"*(p.408).<sup>57</sup>

Fourth, on the question of a PSC supposedly enabling the Executive Branch to specify all the things that they could do with a PSO, Chassagne notes that the 2004 Combus judgement of the European Court of First Instance clearly states; *"contractual obligations under a public service contract do not constitute PSOs"*(414)<sup>58</sup>

But that is just the beginning of the problems. As we noted earlier, extant EC law both in principle and in actual case law makes it absolutely clear that if you do not have clearly defined and justified PSOs, then any compensation (subsidy) for ferry services may be judged illegal State aid. This is not an abstruse point, this is what concerned the Executive Branch in the first Session of Parliament 1999-2003. But, most bizarrely of all, if the Executive Branch was in now in any doubt about the need to apply clearly defined and justified PSOs if you want to subsidise ferry services, all they had to do was to consult the Commission announcement<sup>59</sup> of the decision to investigate the possibility of illegal State aid by the Executive Branch to CalMac and Northlink ferry services which had been made public some months ago and to which the Executive Branch had been invited to respond. Right at the beginning of this document, the fourth paragraph of the Summary reads:

*With respect to the grants awarded to CalMac, NorthLink 1 and NorthLink 2 the Commission questions whether these grants correspond to properly defined public service obligations within the meaning of EC law, and has doubts as to whether the related compensation is compatible with the common market.<sup>60</sup>*

The rest of the document is largely concerned with noting cases where the Executive Branch may have failed to properly define public service obligations (and adherence to the Altmark criteria) and possible implications under State aid law.

How the Executive Branch could still now deny that properly defined public service obligations (and the Altmark criteria) were not only relevant but essential for ensuring that subsidised ferry services do not run the danger of falling foul of EC law here, is simply difficult to comprehend. Even if, despite the Executive Branch's statements in this matter, the Commission subsequently takes a view (contrary to that of the Executive Branch) that clearly defined PSOs can indeed be somehow identified within the PSCs in question, why take the unnecessary risk that the Commission will not take such a view? I made these points consistently and forcibly since I

first became aware of the problem, including in a letter to the Minister<sup>31</sup> in July 2006, but none of this appears to have had any discernable effect.

In short, it appears that the Executive Branch's evidence on what they understood by EC law in this context was not only wrong on a number of counts, it was so badly wrong as to represent a complete misunderstanding and misrepresentation of what had been known for a number of years to be accepted EC law here, posing real problems and dangers for the public interest.

It should be emphasised that this is without prejudice to whatever the Commission might decide in their current investigation into alleged illegal subsidies to Scottish ferry services. The Commission may indeed take a sympathetic line to the Executive Branch's interpretation of EC law here, the point is the Executive Branch's approach to these problems has exposed the public interest here to completely unnecessary risks on these grounds, as well as failing to provide a coherent foundation for the formulation of past, present, and future policy in this context.

Finally, we note in passing that in August 2007 the Executive Branch announced details<sup>62</sup> of a Road Equivalent Tariff (RET) pilot scheme for setting ferry fares in Scotland. RET involves setting ferry fares on one measure of the comparative cost of travelling an equivalent distance by road. The pilot scheme started on 19 October 2008 with RET applied to several routes in the Western Isles. The pilot was scheduled to run for 2½ years from October 19 2008 to Spring 2011.

The Executive Branch argued that the high cost of ferry fares have been seen by many as a barrier to economic growth on the islands and on this point there is widespread agreement. I had previously conducted a review<sup>63</sup> in 2001 of CalMac fares policy and concluded there was an economic case for a significant fares decrease across the board. That still leaves the question of whether the RET approach can be justified on economic and social grounds, whether in principle and/or in practice.

Reviewing RET goes beyond the scope of the present analysis, from the point of view of its place here it is sufficient to note that when the European Commission was asked by an MEP regarding its attitude to RET, the Commissioner replied that even if RET was used as a basis for pricing and subsidising ferry services, EU law on maritime cabotage and State aid would still apply.<sup>64</sup>

Beyond RET, the fundamental problem here is to fathom a coherent way forward when the Executive Branch appears to know less now about the proper regulatory and legal basis

for the formulation and implementation of ferry policy than was expressed in *"Delivering Lifeline Ferry Services"* in 2000.

#### 4. Conclusions

It is difficult to overstate both the scale of the failures in policy making with respect to Scottish ferries post-devolution, nor how unnecessary such failures have been. The context was set in 2000 with what can be seen as little more than a hasty response by the newly-formed Scottish Executive to comply with EC law here in a matter of months. In principle, the old Scottish Office pre-devolution could be criticised for apparently having been slow to respond to the policy needs here, since the Maritime Cabotage Regulation had been put in place in 1992, while relevant EC State aid legislation here dated from even earlier periods. The time horizon set out by the Executive Branch for compliance (which I pointed out at the time was never realistic) was used as a justification for shelving any proposals for the kind of statutory framework and regulatory oversight that was by now regarded as normal practice for protecting the public interest in the provision of essential services which were to be subject to competitive tendering and EC law. Had the proper steps been taken, there would have been no need to start with a blank page. Lessons could have been drawn from precedents associated with other such industries providing essential services, and a coherent statutory framework and derivative rules and guidelines would have set out the roles and functions of the basic building blocks for such an exercise, such as an independent Regulator, Operator of Last Resort (OLR), and public service obligations (PSOs). It would also have constrained the policy making *ad hocery* which has characterised this area in subsequent years

The most obvious and direct failures in the first Session of the Scottish Parliament 1999-2003 were in the context of domestic and administrative failures to provide adequate regulatory oversight and safeguards. However, as we have seen, the regulatory issues of independent Regulator and OLR had spillover implications for the Executive Branch in terms of potential issues relating to compliance with EC law. The dangers here were exacerbated in the periods of the second and third Sessions of the Scottish Parliament by the Executive Branch's rejection of PSOs and the Altmark criteria in this context – despite the clear and consistent messages from the European Commission and the European Court that if you want to subsidise Scottish ferry services you have to have both clearly defined PSOs, and adhere to the Altmark criteria.

We now stand at a position for which I can find no precedent, indeed it is difficult to discern logic behind it. We have a situation in which commentators (author included) have been interpreting and advising what has been accepted good practice in terms of regulatory standards, and essential practice in terms of EC law, yet on major issues that advice

has tended to be consistently rejected by the Executive Branch. Even when it has become absolutely clear that the European Commission supports these positions on issues such as an independent Regulator, PSOs and Altmark, the Executive Branch either explicitly rejects or continues to ignore such arguments. This is a situation where even when a position can be shown to be demonstrably false there appears to be no effective way to alter it. It is with that mindset that the Executive Branch's ferry policy has steamed full speed ahead into the current European Commission investigation into alleged illegal subsidies to Scottish ferry services.

The dangers are now both specific (contingent on the current Commission investigation) and general (with respect to the future of Scottish ferry policy, and the resulting economic and social implications).

On the specific dangers contingent on the current Commission investigation, by default the Executive Branch have effectively ceded much control and discretion over ferry policy to third parties in Brussels. The Commission has already made it clear in their announcement<sup>65</sup> that they see a *prima facie* case that there may have been illegal subsidies to CalMac and/or Northlink, for reasons we have discussed above. One issue which the Commission has signalled they will be looking at is the bundling of CalMac routes<sup>66</sup> raising once again the possibility that the Executive Branch may be forced to break up the network into separate smaller tenders – not for economic or social reasons but because the Commission wish to force through one version of increased transparency, an issue which the Executive Branch has demonstrably failed to deliver to date. Ironically, this tendency to break up of the network may be reinforced by the failure of the Executive Branch to put in place safeguards against cherry picking (cream skimming or market skimming), even though the Commission provided clear guidelines<sup>67</sup> in 2003 on how this could be done under EC law. These omissions had given the moral and legal high ground to potential cherry pickers who had been publicly pressing for the break up of the CalMac network to allow them to target high value / low cost market segments. Unconstrained market entry through cherry picking remains a potential threat to the sustainability of ferry tenders in this context, whether or not routes are to be bundled.

Another issue which is likely to arise<sup>68</sup> in the current Commission investigation is the questions of subsidy to the Gourock-Dunoon CalMac public service when there is an unsubsidised private service close by. There are solutions to this situation consistent with EC law as I have argued<sup>69</sup> but since the Executive Branch has repudiated the use of PSOs, it is difficult to see how they can make any coherent representations on this matter to the Commission.

But more generally, the failures by the Executive Branch here are likely to prejudice and distort any attempts at developing workable policies in this context. In August 2008, the Executive Branch announced a Review of ferry policy;

*The review will include how lifeline ferry services should be procured. It will consider among other things; appropriate legislation and regulations, the use of PSOs and PSCs, how the routes should be bundled together, the need for a tendering system in future and flexibility in contracts.*<sup>70</sup>

But how could such a Review set out to credibly discuss role of PSOs when, as we have seen, the Executive Branch in evidence to Transport Committee only two months earlier had once again completely dismissed any notion that they would use PSOs in this context – together with the totally misleading inference that anything a PSO could do, a public service contract (PSC) could do as well? As for discussion of “*how the routes should be bundled together, the need for a tendering system in future and flexibility in contracts*” there is absolutely no point in discussing strategies and tactics when, as we have noted, you clearly do not understand the rules of the game. The potential scale of public and private involvement in this Review is substantial, but given the premises on which it is built, it also promises to be a considerable waste of these resources and a focus for false expectations

One point that should be noted in passing is that it has been argued that a reason why the Executive Branch has resisted PSOs (in regional air services as well as ferry services) is possibly lack of co-operation and support (or even active resistance) from Whitehall. While the Executive Branch has devolved authority here, the UK is still the recognised national authority from the perspective of Brussels. If Whitehall was concerned that awarding PSOs for Scottish regional air and ferry services could trigger a wave of “me-too” lobbying for PSO-supported subsidies from other regional transport services south of the border, then they might be reluctant to support such mechanisms.

There is not enough information in the public domain at this point to judge and evaluate the role of UK authorities, if any, in this context. What can be said is that even if the attitude of the UK authorities could be construed as actively unhelpful, this does not explain the extent and persistence of the failures on the part of the Executive Branch that we have documented here.

If there is a common theme running through the problems we have discussed here, it is that we have seen that, if faced with a choice between recognising and accepting incontrovertible facts and evidence versus sticking to discredited past decisions and policies, the Executive

Branch's default option is for the latter. If the responsible departments we were dealing with were private or commercial organisations, such failings would usually not be tolerated for long and would normally be fairly easily exposed and dealt with. However, government departments raise more complex issues of adaptability, responsibility and accountability.

Before any solutions can be developed here it must be clearly understood where the problems lie. It is ultimately a question of competences and capabilities, or, more precisely, the lack of them. The first step is to define the problem as not just another transport issue but as one of one of regulatory issues for an industry providing essential services under EC law. Once that is done, then it opens up real possibilities for drawing on lessons, precedents, guidelines and statutory frameworks developed for other essential services.

One part of a coherent path forward would be the appointment of a Task Force composed of qualified experts in the regulation of industries providing essential services, and in EC Competition and State aid law, to advise how policy options should be framed and pursued here. I argued for this in 2005 and it was supported in Parliament by the main opposition party the SNP<sup>71</sup>, but it has not been pursued since it formed the new government in May 2007.

The second part of a coherent path forward would be, having now defined the problem properly, to appoint and give responsibility here to full time administrators and officials here with backgrounds, experience and qualifications in the administration and regulation of industries providing essential services under EC law. This is not to denigrate the competences and capabilities of the officials who have been responsible for developing and administering Scottish ferry policy to date. However, the fact of the matter is that they could not be expected to possess the necessary experience and skills required here since virtually all previous work relevant to the introduction of competitive tendering and de-nationalisation for industries providing essential services had taken place at UK and not Scottish level. Unlike most of the other formerly nationalised UK industries, State owned ferry services were essentially a Scottish phenomenon; indeed their relative unimportance at UK level and political sensitivities at Scottish level were almost certainly contributory reasons as to why it had been left effectively untouched by the wave of de-nationalisations and privatisations of the Eighties and Nineties started by the Thatcher government. But what it also meant was that the repositories of expertise that existed on how to deal with these problems were mostly to be found south of the border.

There should have been, and should be, no shame in looking beyond the Scottish border for the appropriate competences and capabilities; indeed anyone who recognises the merits of

cross border trade knows it can take place in intellectual and administrative human capital as well as other goods and services. Historically, there have been many areas of Scottish competences and capabilities where the cross border trade in human capital has emphasised exporting, so importing necessary competence and capabilities here should not have been controversial or problematic. Had the problem been defined properly to begin with, this part of the solution would automatically have suggested itself. However, given the default tendency of the administrative apparatus for old solutions and procedures despite being discredited, even sensible and logical suggestions are inclined to look hopelessly unrealistic and unattainable in such contexts. While that might not seem an optimistic conclusion, it might be regarded as not unreasonable given that this unresolved and muddled policy debate has already run almost the full course of the reconstituted Scottish Parliament's first decade. The answers you get depend on how you frame the questions, and until the Executive Branch properly frames policy questions here along the lines advocated in this paper, there are major obstacles in the way of obtaining a coherent policy framework that pursues social and economic objectives while still being sustainable and defensible under EC law.

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<sup>3</sup> Delivering Lifeline Ferry Services, Scottish Executive, 2000, <http://www.scotland.gov.uk/consultations/transport/fese-00.asp>

<sup>4</sup> Delivering Lifeline Ferry Services, Scottish Executive, 2000 <http://www.scotland.gov.uk/consultations/transport/fese-02.asp>

<sup>5</sup> "Answers from the Commission and the European Court" <http://www.brocher.com/Ferries/answers.doc>

<sup>6</sup> Council Regulation (EEC) No 3577/92 of 7 December 1992, See Extracts 1 and 6 in <http://www.brocher.com/Ferries/answers.doc>

<sup>7</sup> See Extract 5 in <http://www.brocher.com/Ferries/answers.doc>

<sup>8</sup> Reply from Commissioner Barrot on behalf of the Commission, 10:01:2007, see Extract 3 in <http://www.brocher.com/Ferries/answers.doc>

<sup>9</sup> A precise definition of "essential" or "public interest" services is not provided in EC law, the closest approach to it is recognition of public interest "services of general economic interest", potentially encompassing at least aspects of industries such as gas, electricity,

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<sup>10</sup>Delivering Lifeline Ferry Services, op cit, see page

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<sup>11</sup> Transport and Environment Committee Papers, June 18, 2001, op cit see papers TE/01/18/03 and TE/01/18/04.

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<sup>18</sup>For details of David MacBrayne Ltd, see

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<sup>20</sup>Delivering Lifeline Ferry Services, op cit, see page

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<sup>21</sup>European Commission, State aid C 16/08, op cit

<sup>22</sup> ibid para 70.

<sup>23</sup> Ibid, para 71.

<sup>24</sup>Provisionally estimated (with some uncertainty) for 2002-06 compared to original subsidy set out as per contract, ibid, paras 77-79.

<sup>25</sup>Ibid, paras 65-66.

<sup>26</sup>European Commission, State aid C 16/08, op cit, pPara 113.

<sup>27</sup>See, for example, the Connex rail franchise case in 2003.

[http://www.tssa.org.uk/article-72.php?id\\_article=520](http://www.tssa.org.uk/article-72.php?id_article=520)

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<sup>32</sup>See Scottish Parliament Transport Committee Official Report for meeting 15<sup>th</sup> March 2005

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<sup>34</sup>See

<http://www.brocher.com/Ferries/APPENDIX%203%20%20operator%20of%20last%20resort.doc>

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<sup>36</sup>Communication from the Commission (2003) COM/2003/0595 final page 15 footnote 21

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<sup>37</sup>Though it should be noted the EC tends to take an interest in the issue of an independent authority particularly from the point of view of the award stage of a public service contract. The role of the independent Regulator in regulatory economics tends to encompass that role but also tends to be wider and deeper in terms of helping to buffer the tenderers from political interference and the politicians from corporate lobbying.

<sup>38</sup>See Annex B: The Scottish Executive's Consideration of Academic Papers Submitted to the Local Government and Transport Committee

<http://www.scotland.gov.uk/Publications/2005/09/09104007/40139>

<sup>39</sup>See

<http://www.brocher.com/Ferries/Letter%20and%20Note%20Lifeline%20Ferry%20Services.doc>

<sup>40</sup> Judgment of the Court of Justice of 24 July 2003 in Case C-280/00, Altmark Trans & Regierungspräsidium Magdeburg [2003] ECR I-7747.

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<sup>43</sup> Clyde and Hebrides Lifeline Ferry Services - Scottish Executive's Consideration of the Requirement to Tender 12<sup>th</sup> September 2005 Appendix B

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<sup>45</sup>The Proposed Tendering of Clyde and Hebrides Ferry Services: Problems and an Alternative Proposal: Final Submission to the Consultation Process  
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<http://www.scotland.gov.uk/Publications/2005/09/09104007/40127>

<sup>47</sup>See, for example, the answers from the Commission in 2006 (Extract 2) and 2007 (Extract 3) in  
<http://www.brocher.com/Ferries/answers.doc>

<sup>48</sup>European Commission, State aid C 16/08, op cit.

<sup>49</sup>See Extract 2 <http://www.brocher.com/Ferries/answers.doc>

<sup>50</sup>Executive News Release on the Gourock-Dunoon tender 20<sup>th</sup> March 2003:  
<http://www.scotland.gov.uk/News/Releases/2003/03/3355>

<sup>51</sup>Arthur Conan Doyle (1894) "Silver Blaze":short story in "the Memoirs of Sherlock Holmes", London , George Newnes

<sup>52</sup>Written Answers 13<sup>th</sup> June 2006 Scottish Parliament  
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<sup>54</sup>Scottish Executive, 2006, Review of Regional Transport Strategies in the UK,  
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<sup>55</sup>Chassagne, O (2006) Overview of state aid control policy in transport, in "The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade, ed. Michael Sanchez-Rydelski London, Cameron May, pp. 389-42.

<sup>56</sup>Scottish Parliament Transport, Infrastructure and Climate Change Committee Tuesday 3 June 2008 op cit

<sup>57</sup>Chassagne, O (2006) op cit p.408

<sup>58</sup>Ibid p.414

<sup>59</sup>European Commission State aid C 16/08, op cit

<sup>60</sup>Ibid.

<sup>61</sup>Letter, "Lifeline Ferry Services", July 2006  
<http://www.brocher.com/Ferries/Letter%20and%20Note%20Lifeline%20Ferry%20Services.doc>

<sup>62</sup>Details are set out through a number of links on the Scottish government website at:

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<sup>63</sup> See

<http://www.brocher.com/Ferries/CalMac%20fares%20review%20EKOS.pdf>

<sup>64</sup>See Extract 4, <http://www.brocher.com/Ferries/answers.doc>

<sup>65</sup>European Commission, State aid C 16/08, op cit

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<sup>67</sup>See section 5.5 in Communication on the interpretation of Council Regulation (EEC) No 3577/92 applying the principle of freedom to provide services to maritime transport within Member States (maritime cabotage) (2003) op cit.

<sup>68</sup>I must declare an interest here as a regular user of both ferry services.

<sup>69</sup>See Scenarios for Gourock-Dunoon

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<sup>70</sup>Transport Infrastructure and Climate Change Committee, August 27, 2008:

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## About the author

Neil Kay is Professor Emeritus, Economics Department, University of Strathclyde, Special Professor, University of Nottingham, and Visiting Professor, University of Queensland 2005, 2006, 2007 and 2009. He is also Academic Associate Judge Business School University of Cambridge; has held two Visiting Associate Professorships in the University of California (Irvine 1980-82) and was Visiting Professor at the European University, Florence, 1987-88. He has been a member of ACOST (Cabinet Office) and DTI working parties and has advised private and governmental institutions, including the European Commission and United Nations Development Programme (UNDP). He has published five books and numerous articles of research on industrial economics and corporate strategies, particularly on topics of diversification, multinationalism, collaborative activity, internal organisation and innovation.

An earlier article by him in this area: Sustainable competition: ferries and competition on the Clyde was published in the Fraser of Allander Economic Commentary, 1999, no 3, 52-61.