III

(Other acts)

EUROPEAN ECONOMIC AREA

EFTA SURVEILLANCE AUTHORITY DECISION

No 70/17/COL

of 29 March 2017

on the Coastal Agreement for Hurtigruten Maritime Services 2012-2019 (Norway) [2018/887]

THE EFTA SURVEILLANCE AUTHORITY ('the Authority'),

Having regard to:

the Agreement on the European Economic Area ('the EEA Agreement'), in particular to Articles 59(2) and 61,

Protocol 26 to the EEA Agreement,

the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice ('the Surveillance and Court Agreement'), in particular to Article 24,

Protocol 3 to the Surveillance and Court Agreement ('Protocol 3'), in particular to Article 1 of Part I and Articles 4(4), 6 and 13 of Part II,

Whereas:

I. FACTS

1. *PROCEDURE*

(1) On 28 April 2014, the Authority received by email a complaint concerning alleged incompatible aid to Hurtigruten ASA ('Hurtigruten') under the Coastal Agreement for the Bergen – Kirkenes route ('Hurtigruten Agreement' or 'HA') for the period 1 January 2012 to 31 December 2019.

(2) A second complaint referring to the HA was received on 9 July 2014. The two complaints are independent, but there are certain overlapping issues. Given that both complaints refer to the HA, the present decision will treat them jointly and refer to them as 'the complaints' (reference will also be made to 'the complainants') throughout the text.

(3) By letter dated 13 June 2014 (supplemented by a letter of 10 July 2014), the Authority requested information from the Norwegian authorities. By letter dated 22 September 2014, the Norwegian authorities replied to the information request. An additional request for information was sent to the Norwegian authorities on 21 November 2014, to which the Norwegian authorities replied by letter dated 16 January 2015.

(4) On 9 December 2015, the Authority adopted Decision 490/15/COL opening the formal investigation procedure into alleged unlawful aid involved in the HA ('the opening decision'). The opening decision was published in the *Official Journal of the European Union* and the EEA Supplement to it on 30 June 2016 ([1]).

([1]) OJ C 236, 30.6.2016, p. 29 and EEA Supplement No 36, 30.6.2016, p. 14.

(5) The Norwegian authorities submitted comments to the opening decision by letter dated 16 February 2016 ([1]). The complainants provided some additional information in response to the comments of the Norwegian authorities ([2]). The Authority did not receive any further comments to the opening decision from third parties.

(6) By letter dated 12 October 2016, the Authority requested information from the Norwegian authorities. By letters dated 21 November 2016 and 21 December 2016, the Norwegian authorities replied to the information request ([3]).

2. *BACKGROUND — THE HURTIGRUTEN AGREEMENT*

(7) Hurtigruten operates transport services consisting of the combined transport of persons and goods along the Norwegian coast from Bergen to Kirkenes, as illustrated in the diagram below:

The Bergen – Kirkenes coastal route

(8) The operation of the service for parts of the period 1 January 2005 to 31 December 2012 was the subject of the Authority's Decision No 205/11/COL ([4]). In that Decision, the Authority concluded that Hurtigruten received State aid that was incompatible with the functioning of the EEA Agreement, in so far as it constituted a form of overcompensation for a public service obligation, and ordered the recovery of the aid.

(9) The operation of the service for the period 1 January 2012 to 31 December 2019 was the subject of a tender procedure initiated on 30 June 2010, when the tender specifications were published on Doffin (online database for public procurement) ([5]).

(10) Following this tender procedure, and on the basis of a bid submitted on 8 November 2010, a contract for the procurement of services for the Bergen – Kirkenes coastal route for the period 1 January 2012 to 31 December 2019 was signed with Hurtigruten on 13 April 2011. Under this contract, Hurtigruten shall perform daily sailings throughout the year with calls at 32 intermediate defined ports between Bergen and Kirkenes. For the Tromsø - Kirkenes and Kirkenes – Tromsø routes, freight transport shall also be provided. The services shall be operated in line with certain capacity and vessel requirements, as stipulated in the contract. Vessels used on the coastal route shall as a minimum have a passenger capacity for 320 passengers, berth capacity in cabins for 120 passengers and freight capacity for 150 euro pallets in a cargo hold with a normal load height. They shall also meet legal and technical requirements as indicated in section 4.4 of the tender specifications.

([1]) Document No 793209.
([2]) Document No 798816.
([3]) Documents Nos 827472 and 833077.
([4]) OJ L 175, 5.7.2012, p. 19 and EEA Supplement No 37, 5.7.2012, p. 1. See also Joined Cases E-10/11 and E-11/11 *Hurtigruten* [2012] EFTA Ct. Rep. 758, upholding the Authority's Decision.
([5]) See www.doffin.no

(11) The maritime services for the Bergen – Kirkenes route are based on maximum fares as regards port-to-port passengers (i.e. public service passengers), which must be approved by the Norwegian authorities. According to the HA, "[p]ort-to-port passengers' are passengers who purchase tickets for travelling on a chosen route in accordance with the normal tariff, with any supplement for cabins and/or meals at their option. Prices for supplementary services must correspond to published prices for the selected standard of cabin and meal. The overall price must in such cases equal the sum of the ticket price and individual prices of the selected supplementary services.' An approved fare is taken to mean the normal fares tariff that applied on this route on 1 October 2004, adjusted in line with the Consumer Price Index. Any subsequent changes to the normal tariff must be approved by the Norwegian authorities.

(12) For other passengers, Hurtigruten is free to set its prices. According to the HA, "[o]ther passengers' are those who are not 'port-to-port passengers'. In other words, they are passengers who purchase travel products for specific routes, defined by the supplier, and which include at least one overnight cabin stay and at least one meal on board, where the supplier has published a combined price for the items included and which cannot be broken down into the individual published prices for the same items, including that the passengers will not be entitled to defined discounts on the travel component of the product. Other passengers also include those purchasing a travel product, defined by the supplier, with at least the abovementioned supplementary services at a combined price, specified per day, but where the passengers themselves select the route where these conditions apply.' The same applies to cabin and meal prices, as well as to freight transport.

(13) For the services covered by the HA, the Norwegian authorities pay a total compensation of NOK 5 120 million for the eight years' duration of the agreement, expressed in 2011 prices, and adjusted in accordance with Statistics Norway's cost index for domestic sea transport ([1]). The compensation allocation for each individual year is as follows:

Table 1

Annual Compensation under the HA

2012	NOK 700 million
2013	NOK 683 million
2014	NOK 666 million
2015	NOK 649 million
2016	NOK 631 million
2017	NOK 614 million
2018	NOK 597 million
2019	NOK 580 million

(14) According to the HA, Hurtigruten is obliged to keep separate accounts for the activities on the Bergen – Kirkenes route and other activities and routes outside the scope of the HA ([2]). In addition, Hurtigruten is obliged to keep separate accounts for the public service obligation ('PSO') routes of the Bergen – Kirkenes main coastal route and the commercial part of the same route.

([1]) If Statistics Norway's cost index is unavailable, Statistics Norway's Consumer Price Index would be used.

([2]) As mentioned in the Authority's Decision No 205/11/COL on the Supplementary Agreement on the Hurtigruten service (OJ L 175, 5.7.2012, p. 19 and EEA Supplement No 37, 5.7.2012, p. 1), section I.2: '[i]n addition to the service covered by the Hurtigruten Agreement, Hurtigruten is a commercial operator and offers round trips, excursions, and catering on the route Bergen – Kirkenes. Moreover, in connection with this route, Hurtigruten also provides transport services in the Geiranger fjord, outside the scope of the Hurtigruten Agreement. Furthermore, Hurtigruten operates a number of different cruises in different European states, Russia, Antarctica, Spitsbergen and Greenland'.

3. *THE COMPLAINTS* [1]

(15) Both complainants have requested confidential treatment.

(16) The complainants' argument that Hurtigruten receives State aid in the form of overcompensation, violating thus Articles 61 and 59 of the EEA Agreement, is centred around the following allegations:

1. The compensation for providing the PSO routes has increased substantially as compared to the previous contract period.

2. Hurtigruten continues to receive compensation for services that are not rendered:

(a) Hurtigruten has cancelled all sailings to and from the port of Mehamn (one of the ports of call covered by the HA) from January 2014 until September 2014 without any objective justification or professional verification, after having itself partially demolished the terminal quay in April 2012, which Hurtigruten was actually using to dock for over 20 months. At the same time, the corresponding compensation granted by the Norwegian authorities has not been reduced, enabling Hurtigruten to receive monthly cost savings amounting to NOK 314 500. As a result, both the second and third *Altmark* conditions would not be fulfilled. The second condition is not fulfilled because the Norwegian authorities have not established a framework or policy for objectively and professionally evaluating loss of service after technical or operational claims by the company, and have not engaged any agency to verify the contested claims. The third condition would not be fulfilled, according to the complainants, because Hurtigruten is paid full compensation for PSO routes where it enjoys a substantial cost reduction as a result of the interruption of the services.

(b) Numerous complaints from several ports and regional authorities regarding frequent and arbitrary Hurtigruten cancellations have been dismissed by the Norwegian authorities and have not resulted in any reduction of the compensation. According to the complainants, certain ports are especially plagued by cancellations due to low passenger numbers and low profitability, especially during the winter season.

The complainants particularly question the *force majeure* definition of section 8 of the HA referring to 'extreme weather conditions' without the use of objective criteria [2]. They also refer to such conditions as not constituting *force majeure* in line with section 8 of the HA, which particularly states that '[o]bstacles that the contracting party should have considered upon entering into the agreement, or could reasonably be expected to avoid or circumvent, shall not be considered to constitute force majeure'. At the same time, the complainants question Hurtigruten's discretion to abuse the absolute sovereignty of the master of the ship, when justifying cancellations that are not due to scheduled maintenance or technical reasons pursuant to section 4-1(3) of the HA.

In conclusion, the complainants submit that the cancellations that do not result in any reduction of the compensation have an adverse effect on the performance of the PSO routes and do not fulfil the second and third *Altmark* conditions.

3. Hurtigruten has shown reluctance to pay port fees, rent and service charges. It stopped paying from January 2014 until May 2014. Furthermore, it attempts to secure special price agreements and seeks repayments of such costs from all relevant ports going back to 2011, while maintaining the public service compensation at the same level.

4. Hurtigruten does not reserve capacity for public service passengers, but rather sells the berth capacity to cruise passengers. Hence, Hurtigruten is paid twice for the same capacity, which provides it with an advantage of NOK 50 to 100 million per year.

[1] Document Nos 748323 and 715314.

[2] The complainants point to the fact that in the call for tender for the 2005-2012 contract period *force majeure* as a result of extreme weather conditions was defined as wind speeds over 25 m/s (full storm). However, in the current HA, 'extreme weather conditions' are defined as 'conditions where ocean and/or wind conditions are such that the ship's captain judges it to be unsafe to continue the sailing and/or arrive at a specific port'. This, according to the complainants, has resulted in the majority of the cancellations during the period 2012-2013 in select ports to have occurred at wind conditions below 15 m/s.

4. *GROUNDS FOR OPENING THE FORMAL INVESTIGATION*

(17) The Authority, in the opening decision, assessed the four conditions of the *Altmark* judgment and expressed doubts that none of them seemed satisfied, and a selective advantage was thus conferred on Hurtigruten within the meaning of Article 61(1) of the EEA Agreement ([1]).

(18) Concerning the first condition of a clear definition of a PSO, the Authority doubted whether the reserve capacity requirement of section 4-2 of the HA could be classified by Norway as a service of general economic interest ('SGEI'), given the low capacity utilisation for the public service and the seasonal fluctuations of commercial passengers' transportation. In addition, the Authority questioned the SGEI definition given the lack of information on berth utilisation and the fact that the cargo transportation for the Tromsø – Kirkenes – Tromsø route has not been price regulated, as required by Article 4(2) of the Maritime Cabotage Regulation ([2]).

(19) As regards the second condition and the requirement that the parameters on the basis of which the compensation was calculated must be established in advance in an objective and transparent manner, the Authority doubted whether the capacity reserve requirement is linked to actual PSO passenger numbers. There has not been, for example, any objective and transparent methodology to calculate in advance the cost per passenger/kilometre. Hurtigruten has established a separate budget incorporating all costs and revenues attributed to the PSO routes. This separate accounting, however, according to the Authority, has not aimed at establishing in advance the parameters of the compensation, which should be directly linked to the actual losses and costs (capacity and passenger costs) incurred by Hurtigruten.

(20) The Authority, further, expressed doubts on the way Hurtigruten's costs have been calculated and how the exact parameters have been established when adjusting the compensation, as provided for in sections 4-1 (item 3), 6 and 7 of the HA (i.e. in case of loss of production, changes in production or in case of unforeseen events). In addition, the Authority noted that there have not been any parameters in place to calculate a reasonable profit margin, and the amount of compensation does not fully reflect the parameters established when Hurtigruten attempts to negotiate lower port fees while maintaining the compensation at the same level.

(21) In relation to the third condition, the Authority expressed its doubts as to whether the Norwegian authorities have ensured that the compensation granted does not exceed what is necessary to cover all or part of the costs incurred in discharging the PSO, taking into account relevant receipts and a reasonable profit for discharging those obligations.

(22) In reaching this preliminary conclusion, the Authority addressed the following allegations put forward by the complainants:

(i) Hurtigruten does not reserve capacity for public service passengers, but rather sells the capacity to cruise passengers, while maintaining the public service compensation at the same level;

(ii) the compensation for providing the public service has increased substantially as compared to the previous contract period;

(iii) Hurtigruten continues to receive compensation for services that are not rendered; and,

(iv) Hurtigruten further attempts to get lower prices for the harbour fees, while maintaining the public service compensation at the same level.

(23) Lastly, as regards the fourth *Altmark* condition, which requires the launching of a tender procedure or a benchmarking exercise with an efficient operator, the Authority, in reference to the tender procedure carried out, which resulted in only one bid from Hurtigruten, doubted whether a tender procedure, such as the one at issue, could be deemed sufficient to ensure 'the least cost to the community'. This is particularly so because Hurtigruten had a significant competitive advantage that reinforced its position in the tender procedure, given that it had already in its possession vessels adapted to the requirements of the tender specifications.

([1]) Judgment in *Altmark Trans GmbH and Regierungspräsidium Magdeburg* v *Nahverkehrsgesellschaft Altmark GmbH (Altmark)*, C-280/00, EU:C:2003:415, paragraph 75.

([2]) Council Regulation (EEC) No 3577/92 of 7 December 1992 applying the principle of freedom to provide services to maritime transport within Member States (maritime cabotage) (OJ L 364, 12.12.1992, p. 7), incorporated into the EEA Agreement by Decision of the EEA Joint Committee No 70/97 (OJ L 30, 5.2.1998, p. 42 and EEA Supplement No 5, 5.2.1998, p. 175).

(24) Moreover, according to the tender specifications, the assignment for carrying out the PSO was advertised as three alternatives. This would indicate the existence of further information and/or weighting criteria among those alternatives. In view of the fact that such information was not included, the Authority doubted whether the tender as designed provided incentives to potential bidders, apart from Hurtigruten, that would have been willing to bid in accordance with the requirements of the three different alternatives and for a different alternative than the one actually chosen.

(25) The Authority finally expressed doubts as to whether the HA is compatible with the functioning of the EEA Agreement, as it did not receive any information from the Norwegian authorities as regards compatibility considerations.

5. *COMMENTS BY THE NORWEGIAN AUTHORITIES*

(26) The Norwegian authorities reiterate their position that the HA does not entail any State aid to Hurtigruten, as all four *Altmark* conditions are met.

5.1. THE ALTMARK CONDITIONS

(27) Concerning the first *Altmark* condition, the Norwegian authorities argue that the relevant SGEI is the continuous and daily transportation of passengers and cargo throughout the Norwegian coast with more than 30 ports-of-call, making sure that there is sufficient capacity available for the PSO passengers on all stretches during the whole year. The fact that there is surplus capacity, for instance on certain stretches and particularly during the winter season, is inevitable, and should not call into question the definition of the SGEI. Moreover, this spare capacity does not indicate that similar transport services would have been provided in the absence of the PSO, especially taking into account the lack of corresponding alternatives due to the particularities of the service (i.e. long distances, sparse population base, rough weather, mostly fixed cost base etc.). Rather, according to the Norwegian authorities, the question for the Authority should be to assess whether there has been a manifest error when setting the capacity requirements at 320 for PSO passengers and 120 for berths.

(28) In replying to the Authority's argument in the opening decision concerning capacity utilisation and seasonal variations ([1]), the Norwegian authorities refer to Commission Decision 2013/435/EU on State aid implemented by France in favour of Société Nationale Maritime Corse-Méditerranée (SNCM), where it is stated that '[…] the Commission considers that the shortage of private initiative on each line in relation to a clearly identified need for transport during the off-peak periods of the year alone is sufficient to justify the inclusion of the basic service within the scope of the public service for the whole year for all these lines.' ([2]).

(29) During the investigation, the Authority addressed the possibility of Hurtigruten having a flexible fleet in terms of size according to seasonal variations (e.g. smaller vessels during the winter and larger vessels during the summer). The Norwegian authorities respond that this, although theoretically possible, would in practice be commercially unfeasible because it would require a very large fleet with the possibility of deploying the smaller ships elsewhere during the summer and the larger ships elsewhere during winter.

(30) In addition, on an issue raised by the Authority concerning the necessary minimum size of the vessels to operate the Bergen – Kirkenes coastal route, the Norwegian authorities consider that a certain size is necessary, given the harsh weather conditions at times on the route, to ensure the regularity of the service and the safety of passengers and crew.

(31) In any event, according to the Norwegian authorities, the costs of operating smaller vessels would not be significantly lower. Information submitted shows that costs increase with the size of the vessels, but not proportional to the increase in capacity and berths and this increased capacity will be sold in a commercial market and provide positive contribution (cover all variable costs and part of fixed cost) and thereby reduce the need for public service compensation.

([1]) Opening decision, paragraph 43.
([2]) OJ L 220, 17.8.2013, p. 20, paragraph 147.

(32) Further, the Norwegian authorities stress that if all the vessels in the fleet were of the smallest size possible to operate the coastal route, the compensation granted would be clearly insufficient. On the contrary, the utilisation of larger vessels that could also be used for commercial purposes would allow for cost allocation, thus lower cost for the PSO.

(33) In relation to the need for the set capacity, the Norwegian authorities argue that the capacity was set at an appropriate level (see section 5.3 below on the first BDO report 2016).

(34) Finally, concerning the Authority's doubts as regards the cargo transportation for the Tromsø – Kirkenes – Tromsø route and the fact that this service is not price regulated, the Norwegian authorities argue that it does not follow from Article 4(2) of the Maritime Cabotage Regulation that all requirements indicated therein must be imposed. Hurtigruten has entered into an agreement with Nor Lines AS, whereby the entire capacity for transporting goods has been disposed of, and the annual remuneration under that agreement is directly reflected in Hurtigruten's budget, as submitted in the tender procedure.

(35) On the second *Altmark* condition, the Norwegian authorities cite among others the decision of the General Court in *TV2/Denmark* v *European Commission*, where the General Court stated that the second *Altmark* condition is not meant to impose an obligation on the national authorities to monitor the amount of the expenses incurred by the beneficiary of the compensation ([1]). This condition, therefore, does not, according to the Norwegian authorities, impose any limits on what cost increases could be compensated. Rather, the various cost categories set out in the tender specifications, which form the basis of the separate accounting, combined with appropriate allocation keys to separate PSO from commercial costs, clearly have the aim and effect of establishing the parameters of the compensation, whereas the specific underlying calculation of costs was for the tenderers to carry out during the procurement process.

(36) According to the Norwegian authorities, *Altmark* does not require granting authorities to base exclusively their calculations of the parameters of compensation on a 'cost per passenger/kilometre' model. In the present case, given the complexity of the SGEI provided, this would simply not be relevant, as the amount of compensation was established in advance on an annual basis for the entire term of the HA, whereas Hurtigruten would carry the risk for both increases and decreases of costs and income.

(37) This net contract approach of the HA does not violate, in Norway's view, the second *Altmark* condition. As it is argued, this mechanism serves as an incentive for the company to operate the service in the most cost effective manner, providing it with the possibility to influence its profit margins. Otherwise, with no incentive to influence costs, this would have presumably resulted in a higher cost for the service, as there would be no benefit for the company to run the service in a more efficient manner. The question therefore, according to the Norwegian authorities, is not whether a net contract, such as the HA, fulfil the second *Altmark* condition, but rather whether the level of profit actually achieved is reasonable, taking into account, inter alia, the level of risk associated with the provision of the SGEI.

(38) Concerning the negotiations carried out between the parties, the Norwegian authorities state that, although the actual level of compensation was altered due to the negotiations, the parameters and methodology to calculate the compensation were not in any way amended. These negotiations resulted in the reduction of the compensation by NOK […] million in relation to the initial offer, i.e. from NOK […] million to NOK 5 120 million, reflecting, however, also certain changes made to the tender contract.

(39) Regarding the Authority's doubts on several contract clauses allowing adjustment of compensation in case, for instance, of changes in production or in case of unforeseen events, the Norwegian authorities argue that these should not be assessed on a stand-alone basis but as part of the contract as a whole ([2]). Moreover, according to the HA such clauses cannot lead to any production changes of a material scope, and the final compensation has to reflect the increased costs or revenues stemming from the changes. It is also stated in the Norwegian submission that these clauses do not intend to cover any unforeseen losses or costs, but simply ensure that the economic balance of the HA is retained ([3]).

([1]) Judgment in T-674/11, ECLI:EU:T:2015:684, paragraph 103.
([2]) See judgment in Joined Cases E-10/11 and E-11/11 *Hurtigruten* [2012] EFTA Ct. Rep. 758, paragraph 122.
([3]) SNCM, paragraph 197.

(40) With reference to the off-hire provision in the HA section 4-1 (item 3), the Norwegian authorities consider that due to past experience of Hurtigruten on the service, at least 110 operating days (10 for each ship) per year for planned maintenance and unforeseen operational disturbances are needed, in order for the company to be in full compliance with all applicable requirements for the safe operation at sea. Information has been submitted showing that in the period 2007-2014, in most cases the 110 days ceiling has been exceeded, indicating therefore that that ceiling was not set high.

(41) As regards the port fees, the Norwegian authorities note that these represent a cost element for Hurtigruten. The level of port fees and other charges has been based on the Norwegian Ports Act ('NPA') 2009, and as such, they were included in the tender documents. However, after the HA entered into force, Hurtigruten was notified of substantial price increases in some ports and a general price increase in many others, beyond the scope of the inflationary index covered by the HA. According to the Norwegian authorities, there has been a total increase of 40,4 % in the port fees since 2009 (including the commercial operations) ([1]). Thus, any reduction of the new and increased level of port fees cannot be considered to entail elements of State aid, as the compensation is based on the lower, original port fees.

(42) Finally, on the Authority's doubts that there has not been any methodology to calculate a reasonable profit, the Norwegian authorities state that this is calculated on the basis of earnings before taxes in relation to the total revenue ('EBT'), taking into account the particular risks associated with the provision of the SGEI as defined, and in accordance with Annex D to the tender specifications, which sets out in detail how the compensation for the PSO is calculated including principles for allocation of costs. Following negotiations, the final compensation resulted in an EBT of […] %. However, the actual profit margin has been clearly lower: […] % (2012), […] % (2013) and […] % (2014). Moreover, when this EBT was converted to a more appropriate measure of return such as return on capital employed ('ROCE'), the Norwegian authorities have explained that the estimated ROCE of the contract was within a reasonable interval (see paragraphs (73) and (74) below concerning the second BDO report of 2016).

(43) Concerning the third *Altmark* condition, the Norwegian authorities' reply centres around the argument of wide discretion that they enjoy when it comes to the model of cost allocation, and that the Authority's assessment is limited to the question of whether there has been a manifest error in the assessment.

(44) The Norwegian authorities also point out that this condition does not necessarily entail that clawback mechanisms or contractual arrangements to alter the level of compensation must always be in place to avoid overcompensation. Rather, '[…] any mechanism concerning the selection of the service provider must be decided in such a way that the level of compensation is determined on the basis of these elements' ([2]). As Hurtigruten has so far not received compensation exceeding the coverage of the costs and the profit margin related to the agreed compensation, there has not been a need for such a clawback mechanism.

(45) On the level of the reasonable profit, the Norwegian authorities have argued that profits may vary over the years, and that contracts providing incentives for the service provider do not necessarily signify overcompensation.

(46) In addition, the Norwegian authorities explained that a financial evaluation had been carried out before the tender invitations, describing estimates on expected costs and revenues, as well as expectations for a rate on return on capital ('RoC'), presented as a weighted average cost of capital ('WACC'), to be within an interval of […] % to […] % on the total capital ([3]). A subsequent financial evaluation was conducted to examine Hurtigruten's bid and concluded that it would entail a higher RoC, which could lead to cross-subsidies of the commercial operations ([4]). As a result, the Norwegian authorities entered into negotiations that resulted in a reduction of the compensation, which was considered to be acceptable (as described in paragraph (42)). The results achieved through the negotiations have been examined and substantiated by the latest financial evaluation of BDO (see section 5.4 below on the second BDO report 2016).

([1]) The complainants state that according to the Norwegian Ports Association, the cost increase on the coastal route from 2009-2014 was around 17 %. The increase is partly due to general price increases, partly due to the increased average gross tonnage of Hurtigruten's fleet, and partly due to higher costs for maintenance and infrastructure development because of stricter regulations and standards for infrastructure projects.

([2]) Application of the State aid rules to compensation granted for the provision of services of general economic interest (OJ L 161, 13.6.2013, p. 12 (Annex I) and EEA Supplement No 34, 13.6.2013, p. 1), paragraph 60.

([3]) BDO Memo, '*Price estimates, accounting separation and reporting*', Oslo 22 February 2010.

([4]) BDO Memo, '*The Bergen – Kirkenes route — New alternatives for price estimates*', Oslo 9 June 2010.

(47) With regard to the Authority's concern in the opening decision that Hurtigruten does not reserve capacity for public service passengers, but rather sells the capacity to cruise passengers, while maintaining the public service compensation at the same level, the Norwegian authorities stress that the HA does not prohibit Hurtigruten from selling tickets to cruise passengers as long as there is no demand from PSO ones.

(48) In any case, according to the Norwegian authorities, Hurtigruten has a fairly low capacity utilisation of its ships ([…] %). As a result, in the vast majority of cases there is free capacity. Furthermore, the number of extra commercial tickets sold is generally low (see section 5.3 below on the first BDO report 2016).

(49) The Norwegian authorities acknowledge that in rare cases, PSO passengers, within the reserved capacity of 120, are not able to get a berth. However, this is compensated by the travel guarantee introduced on 24 September 2014 ([1]).

(50) In relation to the issue of the substantial increase in the compensation under the HA, as compared to the previous contract for the period 2005-2012, the Norwegian authorities state that the current HA must be assessed independently of the previous one, taking into account the actual costs of running the service and the account separation principles as explained in the BDO report 2015 (see section 5.2 below).

(51) Further, on the Authority's argument that Hurtigruten continues to receive compensation for services that are not rendered, the Norwegian authorities underline that a large portion of the costs stemming from the PSO obligations are capacity costs that remain unaffected by the number of passengers on board at any given time. In addition, cancellation of ports, for example due to extraordinary weather conditions, do not reduce the fixed costs (with the exception of the port fees), but rather generate additional costs for the company ([2]).

(52) It is also argued in Norway's submission that the level of compensation under the HA is based on the division of risks and obligations between the parties. That is to say, the risk of non-performance due to extreme weather conditions was transferred to the granting authority in the negotiations between the parties, and the level of compensation was thus reduced accordingly, without this creating any difficulties in relation to the third *Altmark* condition.

(53) In reference, lastly, to the cancellations of the services to the port of Mehamn, the Norwegian authorities provide a description of the events, indicating that the damages to the port were compensated by the company in the autumn of 2012 and that the port was not repaired despite Hurtigruten's request. The failure of the port authority to repair the damages led to a gradual deterioration of the pier, which resulted in the company, following an agreement with the granting authority, stopping calls in the port from January 2014 until it was repaired and officially opened for Hurtigruten again in September 2014. Meanwhile, a land-based transport of cargo was established and the port time in Kjøllefjord was increased.

(54) In any event, it is submitted by the Norwegian authorities that, as part of the 2014 financial review, due to the fact that the granting authority and Hurtigruten reached an agreement to cancel calls to the port, this cancellation is considered as a change in production in accordance with section 6 of the HA, leading to an adjustment of the final compensation. Therefore, this cancellation cannot be considered as a breach of the HA and does not entail any overcompensation under the HA.

(55) Concerning the fourth *Altmark* condition and the doubts expressed by the Authority whether a tender procedure such as the one in the case at hand, where only one bid is submitted, can be deemed sufficient to ensure the least cost to the community, the Norwegian authorities claim that the present tender has been carried out as an open procedure in line with the public procurement rules.

([1]) In situation where a PSO passenger is unable to get a berth, under the travel guarantee he can either require free travel without berth on the planned journey or free travel with berth on the next scheduled journey. The travel guarantee was not invoked in 2014, but was used 15 times in 2015.

([2]) Relating among others to changes in the passengers' bookings, finding alternative transportation for passengers and cargo, costs to cover refunds, plane tickets, hotels, taxi and bus charters.

(56) The Norwegian authorities also argue that using the 'lowest price' as the sole award criterion cannot be meant to have violated the fourth *Altmark* condition ([1]).

(57) Further, in reference to the three alternatives routes mentioned in the tender, the Norwegian authorities explain that according to the case law of the Norwegian Complaints Board for Public Procurement ('KOFA'), if no instructions are given to the tenderers on the alternatives, the award must be based on an assessment of which offer in total appears to be the economically most advantageous. The Norwegian authorities refer also to the tender specifications, section 2.14, where it is stated that the contracting authority reserves the rights to choose freely between the tendered alternative ([2]).

(58) On the issue of only one bid having been submitted, which is in principle insufficient to ensure compliance with the fourth *Altmark* condition, the Norwegian authorities consider that this in itself cannot be understood as a general exclusion. In fact, a further assessment must be carried out as to whether the procurement procedure nevertheless gave rise to a sufficiently open and genuine competition. In the opinion of the Norwegian authorities, several measures were indeed taken to accommodate competition amongst the different operators (e.g. alternative models, reduced capacity, sufficient time period between bids and start-up date, time extension for bids' submission). Further, Hurtigruten was aware that other companies had at least shown an interest in participating in the tender process.

(59) Concerning the compatibility conditions, the Norwegian authorities acknowledge that the SGEI Decision is not applicable as the HA has exceeded the 300 000 passengers threshold during the two financial years before the PSO was assigned ([3]).

(60) Although, in Norway's view, the measure does not constitute State aid pursuant to *Altmark*, if it were to be assessed pursuant to the Authority's Framework for State aid in the form of public service compensation ('the Framework') ([4]), it would meet all the compatibility conditions specified therein.

(61) Particularly in reference to proportionality, the Norwegian authorities argue that the calculations made are in conformity with the case law requirements and the European Commission's decision-making practice, as only the actual costs for discharging the PSO obligations have been taken into account, pursuant to a correct allocation of costs and revenues between the PSO and the commercial services, and taking into account a reasonable profit of […] % (EBT).

5.2. THE BDO REPORT 2015 ([5])

(62) The Norwegian authorities commissioned a report from the consultancy BDO, which looked at Hurtigruten's budgeted and actual financial performance in 2012 and 2013, for, separately: (a) the services purchased by the government on the Bergen-Kirkenes route; and (b) the totality of services provided by Hurtigruten on the same route (i.e. including both commercial and government-procured services).

(63) In this exercise, BDO distinguished between capacity costs, passenger costs, and costs relating to marketing and sales activities.

(64) Capacity costs, which are regarded as fixed costs, are defined as the costs incurred by the vessels sailing the set route with specific ports of call and are to include all activities associated with the operation of vessels along the coast. Capacity costs consist of the following elements: safety crew, oil and fuel, repairs and maintenance, port

([1]) Application of the State aid rules to compensation granted for the provision of services of general economic interest (OJ L 161, 13.6.2013, p. 12 (Annex I) and EEA Supplement No 34, 13.6.2013, p. 1), paragraph 67.

([2]) Section 2.14 continues: 'The choice will be made on the basis of an assessment of the price level of the different alternatives compared with the differences in frequency the different alternatives represent. Once an alternative has been selected, the contracting authority will choose the tender that offers the lowest price for the entire contract term (at 2011 prices)'.

([3]) Commission Decision 2012/21/EU of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (OJ L 7, 11.1.2012, p. 3), incorporated at point 1h of Annex XV of the EEA Agreement.

([4]) OJ L 161, 13.6.2013, p. 12 (Annex II) and EEA Supplement No 34, 13.6.2013, p. 1.

([5]) BDO Memo, '*An assessment of Hurtigruten's reported income statements*', Oslo 14 January 2015.

costs, insurance costs, vessel depreciation/leasing and net financial costs. Passenger costs, as well as costs relating to marketing and sale activities, are all regarded as variable costs. They include all activities directly or indirectly related to passenger traffic. Passenger costs consist of the following elements: costs of goods sold, crew not included in the safety crew, marketing costs and sales provisions, administrative costs and other costs.

(65) Capacity costs were then allocated to the government-procured services on the basis of the share of capacity reserved by the government compared to the total capacity of the fleet, whereas passenger costs were allocated on the basis of estimated passenger kilometres sailed by distance travellers over the total number of passenger kilometres for all travellers on the fleet. The marketing and sales costs were allocated to the government-procured services on the basis of the share of estimated net passenger revenue relating to the PSO passengers compared to the total number of travellers.

(66) According to the report, in both segments (a) and (b) mentioned above in paragraph (62) and in both 2012 and 2013, there was a shortfall in Hurtigruten's actual results as compared to the figures budgeted by the company in its tender documents. BDO submits that the fact that Hurtigruten registered a net loss on its commercial operations should not be seen as evidence of cross-subsidisation. This is because the gross margin on commercial passengers activities is positive, but insufficient to cover the corresponding fixed capacity costs (because the actual number of commercial passengers has been below budgeted levels), hence the overall net loss of commercial operations.

5.3. THE FIRST BDO REPORT 2016 [1]

(67) This second report, commissioned by the Norwegian authorities, analyses the appropriateness of the minimum capacity requirement of the HA for the period 2012-2019. In order to reach its conclusion, the report assesses all sailings on all ships between all ports-of-call in the years prior to the tender, i.e. the years 2008-2010, on the basis of detailed statistics received from Hurtigruten, concerning the number of passengers travelled with each ship on the different dates and legs in 2015, taking also into account the results of a study undertaken by TØI in 2002 for the same purpose in the context of the agreement covering the period 2005-2012 [2].

(68) The report assumes that since the legs' utilisations seemed to be the same in 2015 and 2002, and since there has been little change in seasonal variations, this situation remained constant between 2008 and 2010 as well.

(69) According to the report, there are a fair amount of PSO passengers on all legs during the year. However, the numbers are clearly higher during the summer months. Specifically, in the period June to August around 1/3 of the sailings are performed with 320 PSO passengers or more on at least one leg. The average maximum number of PSO passengers during these months is around 285, whereas during the periods January to May and September to December the number is around 142 [3].

(70) The report further considers that there is a large variation in the number of PSO passengers per leg. Out of a total 70 legs (as shown in the figures presented in the report), in 14 legs the maximum number of PSO passengers exceeded 320 for the years 2008 and 2010. In 2009, there have been 7 legs where the maximum number of PSO passengers exceeded 320.

[1] BDO Memo, '*Analysis of Distance Travellers using Hurtigruten*', Oslo 12 February 2016.
[2] TØI rapport 609/2002 — Utredning av transportstandarden for kysten Bergen – Kirkenes.
[3] The report also states that the average number of PSO passengers (considering all legs) during June to August is around 112, whereas during the periods January to May and September to December the number is around 55. 'Sailing' is defined as one ship sailing the whole route Bergen – Kirkenes – Bergen, whereas 'leg' is the one-way sailing between two ports along the route.

(71) As far as berth utilisation is concerned, the report considers that for the year 2015, on every leg, the average maximum number of berths used by PSO passengers was 225, whereas the average number of berths used by PSO passengers was around 60 ([1]).

(72) Finally, the report states that in the vast majority of sailings, there was capacity for at least 320 PSO passengers on all legs.

5.4. THE SECOND BDO REPORT 2016 ([2])

(73) The Norwegian authorities commissioned a second report from BDO in the fall of 2016, asking the consultants to create an alternative model for assessing reasonable profit based on ROCE and the cost allocation methodology presented in the tender document, Annex D. The purpose was firstly to estimate the expected level of ROCE on the contract as it was agreed (i.e. the full contract period), and secondly, to define an interval of reasonable profit on the contract based on a set of benchmarks.

(74) BDO estimates that the ROCE on the PSO contract was […] %. BDO compared this to three different benchmarks: WACC of […] % as calculated by an independent brokerage firm in 2009 when they followed Hurtigruten on the stock exchange; the discount rate of […] % applied in the depreciation tests used in the financial statements of Hurtigruten in 2009; and a benchmark of […] % based on four publically traded companies active in passenger cruise activities. BDO also calculated the running average actual ROCE from 2012-2015 to be […] %.

6. *COMMENTS BY THE COMPLAINANTS TO THE COMMENTS MADE BY THE NORWEGIAN AUTHORITIES*

(75) The complainants obtained a non-confidential version of the comments submitted by the Norwegian authorities through a public information request to the respective authorities.

(76) The complainants support the definition provided of the HA as an SGEI in terms of route production, due to the fact that such a service could not be provided by the market alone considering the sparse population, lack of infrastructure and remoteness of the northern Norwegian regions.

(77) Concerning the capacity requirement, the complainants believe that for a majority of the ports served, this is of secondary importance, as what matters is the fact that there are daily and regular sailings providing passenger and cargo services in the coastal route.

(78) Nevertheless, the complainants argue that the compensation provided for in the current HA is too high compared to the reduced number of PSO passengers (the cost increase on the coastal route from 2009-2014 was around 17 %), and given that the total utilisation capacity has been increased, the compensation is meant to cover any potential shortfall in the commercial utilisation of the capacity, in order to maintain the same level of PSO service.

(79) Finally, the complainants criticise the lack of a clawback mechanism in the HA or a clear compensation cap, which, if existed, would provide sufficient efficient incentives, while at the same time ensuring that there is no overcompensation.

II. **ASSESSMENT**

1. *THE PRESENCE OF STATE AID*

1.1. THE CONCEPT OF STATE AID

(80) According to Article 61(1) of the EEA Agreement, a measure constitutes State aid if the following conditions are cumulatively fulfilled. The measure: (i) is granted by the State or through State resources; (ii) confers a selective economic advantage on the beneficiary; (iii) is liable to have an impact on trade between Contracting Parties and to distort competition.

([1]) Information concerning berths used by PSO passengers during 2008 to 2010 has not been available.
([2]) BDO Memo, '*An assessment of the rate of return*', Oslo, 19 December 2016.

(81) In its opening decision, the Authority concluded that points (i) and (iii) are met. The Norwegian authorities have not provided any further information disputing this finding. Therefore, the Authority will only herein assess whether the HA has conferred a selective economic advantage on Hurtigruten.

1.2. SELECTIVE ECONOMIC ADVANTAGE ON HURTIGRUTEN

(82) In order to constitute State aid, the aid measure must confer on Hurtigruten an advantage that relieves it of charges that are normally borne from its budget.

(83) It follows from the *Altmark* judgment that where a State grants compensation for services provided by the recipient undertakings in order to discharge PSOs, such a measure is not caught by Article 61(1) of the EEA Agreement. In the *Altmark* judgment, the Court of Justice held that compensation for PSOs does not constitute State aid when four cumulative criteria are met:

(i) 'First, the recipient undertaking must actually have public service obligations to discharge and such obligations must be clearly defined;

(ii) Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner […];

(iii) Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations;

(iv) Fourth, where the undertaking which is to discharge public service obligations is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.' ([1]).

1.2.1. ***The first Altmark condition***

(84) In the opening decision, the Authority stated that the PSOs are clearly defined in section 4-1 of the HA in terms of route production requirements (i.e. the daily, year round and regular passenger sailings between Bergen and Kirkenes with calls at 32 intermediate defined ports, as well as freight transportation between Tromsø and Kirkenes), in section 4-2 of the HA, as regards the vessel requirements, and in section 4-3 of the HA, as regards fare and discount requirements, with the exception of freight transportation.

(85) The Authority, however, expressed doubts whether the reserve capacity requirement of section 4-2 of the HA can be classified by Norway as an SGEI, taking into account the seasonal fluctuations of commercial passenger transportation. According to the HA, vessels used on the coastal route shall as a minimum have a passenger capacity for 320 passengers, berth capacity in cabins for 120 passengers and freight capacity for 150 euro pallets in a cargo hold with a normal load height.

(86) In addition, the Authority had not received any information on berth utilisation, while as regards the cargo transportation for the Tromsø – Kirkenes – Tromsø route, the Authority doubted whether the PSO for freight transportation has been clearly defined under the HA, given the fact that this is not price regulated, as required by Article 4(2) of the Maritime Cabotage Regulation. According to section 4-3 of the HA, Hurtigruten has full freedom to set the fares.

(87) The fulfilment of the first *Altmark* condition must be assessed with regard to Article 4, paragraph 2 of the Maritime Cabotage Regulation, which sets out the specifications that should be part of the definition of a PSO, namely: ports to be served, regularity, continuity, frequency, capacity to provide the service, rates to be charged and manning of the vessel.

([1]) Judgment in *Altmark*, C-280/00, EU:C:2003:415, paragraphs 87-93.

(88) Further, in accordance with section 9 of the Authority's Maritime Guidelines, '[p]ublic service obligations may be imposed or public service contracts may be concluded for the services indicated in Article 4 of Regulation (EEC) No 3577/92' ([1]).

(89) In the absence of specific EEA rules defining the scope of the existence of an SGEI, the Norwegian authorities have a wide margin of discretion in defining a given service as an SGEI and in granting compensation to the service provider. The Authority's competence in this respect is limited to checking whether Norway has made a manifest error when defining the service as an SGEI ([2]). For example, in the context of defining specific routes, the Communication on the interpretation of the Maritime Cabotage Regulation confirms that '[i]t is for the Member States […] to determine which routes require public service obligations. In particular, public service obligations may be envisaged for regular (scheduled) island cabotage services in the event of market failure to provide adequate services' ([3]).

(90) According to the case law, PSOs may only be imposed if justified by the need to ensure adequate regular maritime transport services, which cannot be ensured by market forces alone. It is important for the national authorities therefore to demonstrate that there is a real public service need for the PSO ([4]).

(91) The question is whether the Norwegian authorities have committed a manifest error in setting the minimum capacity reserve at 320 PSO passengers, berths for 120 passengers and freight capacity for 150 euro pallets.

(92) In the opening decision, the Authority stressed based on the information provided ([5]), that the compensation received by Hurtigruten for reserving capacity for PSO passengers vastly exceeded the actual demand for PSO passenger services. Therefore the Authority could not exclude that such capacity reservation provision for PSO passengers might be unnecessary, especially during the winter season, where the utilisation by commercial passengers would naturally be much lower.

(93) In the course of the investigation, the Norwegian authorities submitted more information on the capacity utilisation by both types of passengers (including berths) and cargo, pointing to the fact that the objective of the service at hand is to ensure that there is sufficient capacity available on *all* stretches of the coastal route at *all* times (see above under section 5.3, first BDO report 2016).

(94) The Authority notes that around 60 % of the share of estimated capacity costs is covered by the public service compensation, whereas only approximately 30 % of the share of estimated passenger costs has been allocated to PSO passengers (based on expected utilisation of the ships by PSO and cruise passengers respectively), pointing thus to a potential cross-subsidisation of the commercial activities, stemming from the defined minimum capacity reserve.

(95) Nevertheless, the Authority acknowledges that the capacity utilisation can, by the nature of the service in question, have substantial regional and seasonal variations, as PSO passengers often sail shorter stretches than the commercial passengers. Furthermore, during peak periods, in particular the commercial capacity utilisation rate is

([1]) OJ L 240, 13.9.2007, p. 9 and EEA Supplement No 43, 13.9.2007, p. 1, available also at www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/

([2]) Judgment in *FFSA* v *Commission*, T-106/95, EU:T:1997:23, paragraph 99; Judgment in *British United Provident Association Ltd (BUPA), BUPA Insurance Ltd and BUPA Ireland Ltd* v *Commission of the European Communities (BUPA)*, T-289/03, EU:T:2008:29, paragraph 268.

([3]) Communication from the Commission 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), COM(2014) 232 final, 22.4.2014, section 5.2.

([4]) Judgment in *Alanir and others*, C-205/1999, EU:C:2001:107, paragraph 34.

([5]) BDO Memo 2011, page 7.

high compared to off-peak utilisation rates. Therefore, ensuring the necessary capacity in peak periods and on all stretches has the inevitable result that the vessels in off-peak periods have significant spare capacity within the minimum requirements set in the HA. This is illustrated by the fact that the maximum number of PSO passengers during off-peak periods taking all legs into account is on average around 142, whereas the average number is around 55, as several legs have only few PSO passengers.

(96) In addition, the Authority acknowledges that a service as the one performed pursuant to the HA cannot be provided commercially, considering that most of the operating costs, such as ship cost, payroll and fuel, are largely fixed for the whole duration of the HA and cannot be reduced or eliminated during off-peak periods. In this regard, the Authority agrees with the argument of the Norwegian authorities that redeploying some vessels during the year (i.e. using smaller vessels during off-peak period and larger vessels during peak periods) would not significantly reduce the operating costs. On the other hand, it would create an additional economic burden for Hurtigruten as it would need to find other markets to redeploy the non-used vessels.

(97) Moreover, as regards the minimum necessary size of the vessels to operate the coastal route, the Authority takes note of the fact that the regularity of the service, as well as safety considerations would justify a certain size of the vessels.

(98) As mentioned earlier, the EFTA States have discretion in defining an SGEI, taking also into account specific PSOs pursuant to Article 4(2) of the Maritime Cabotage Regulation and other characteristics (e.g. technical specificities), as defined in the tender specifications in this case, to the extent that a manifest error is not committed. In view of the above, taking in particular account of the fact that, as shown above in paragraph (69), there is a fair amount of PSO passengers on all legs along the coast throughout the whole year, the Authority considers that the Norwegian authorities' definition of the minimum capacity reserve, even though it exceeds the average expected demand for PSO services, is not manifestly erroneous.

(99) The Authority further notes that the complainants in their submissions support the definition provided of the HA as an SGEI, which could not be provided by the market alone considering the sparse population, lack of infrastructure and remoteness of the northern Norwegian regions.

(100) As regards the doubts expressed in the opening decision related to the cargo service not being price regulated, the Authority agrees with the Norwegian authorities that Article 4(2) of the Maritime Cabotage Regulation does not require States to impose all the obligations indicated therein on the service operators. Indeed, public authorities have considerable discretion as regards the way in which they choose to manage, organise and finance their SGEIs ([1]).

(101) Taking therefore into account the lack of private initiative with regard to servicing the Bergen – Kirkenes coastal route, the economic, technical and geographical considerations mentioned above, as well as the capacity utilisation considerations presented in the first BDO report 2016, the Authority cannot conclude that the setting of the minimum capacity reserve at 320 PSO passengers, berths for 120 passengers and freight capacity for 150 euro pallets went beyond what was necessary and proportionate to the real public service need.

(102) In light of the above, the Authority considers that the PSO for the reserve capacity requirement of section 4-2 of the HA was sufficiently clearly defined and the first *Altmark* condition hence met.

(103) The Authority will now assess whether the fourth *Altmark* condition is met.

([1]) As previously mentioned in paragraph (34), Hurtigruten has concluded an agreement with Nor Lines AS concerning the disposal of cargo capacity on the Hurtigruten ships. By way of this agreement, Nor Lines is given the right to use Hurtigruten's cargo space for the transportation of cargo on the Bergen-Kirkenes route, against remuneration that been agreed between the contracting parties and is reflected in the budget submitted for the tender.

1.2.2. ***The fourth Altmark condition***

(104) In the opening decision, the Authority doubted whether a tender procedure where only one bid is submitted could be deemed sufficient to ensure 'the least cost to the community' ([1]). As mentioned, Hurtigruten had already been running this particular maritime service consisting of the combined transport of persons and goods along the Norwegian coast from Bergen to Kirkenes for years ([2]). As the incumbent operator, Hurtigruten thus had a significant competitive advantage that reinforced its position in the tender procedure, given that it had already in its possession vessels adapted to the requirements of the tender specifications.

(105) In view of the information submitted by the Norwegian authorities during the course of the investigation, the Authority maintains the view that the public procurement procedure, which resulted in the selection of Hurtigruten, has not allowed for an open and genuine competition. This is despite the fact that several measures were taken by the Norwegian authorities in order to invite potential tenderers:

(i) providing in the call for tenders for alternative models of sailing;

(ii) reducing the requirement for minimum capacity from 400 to 320 passengers and from 150 to 120 berths; and

(iii) allowing tenderers sufficient time from the deadline for submitting bids (30 September 2010) until the service start-up date (1 January 2013) to purchase or construct vessels for the service, taking also into account the deadline extension until 8 November 2010.

(106) It must be stressed, in this regard, that the specific coastal route has been traditionally served by Hurtigruten under a public service contract for a very long time (even before the conclusion of the EEA Agreement in 1994) ([3]).

(107) For certain contract periods (e.g. 1991-2001 and 2002-2004), the contract had been directly awarded to Hurtigruten, whereas for the periods 2005-2012 and 2012-2019, the operation of the service was the subject of a tender procedure with Hurtigruten being the only bidder, and thus winner, of the tender ([4]).

(108) The constant lack of competition in the relevant sector, even with the launch of a tender procedure since 2005, reveals the failure of the market to provide a sufficient number of operators with the necessary financial capacity to fulfil the technical requirements (in terms of capacity and vessel requirements) of the contract.

(109) In reference to the alternative models of sailing to all 34 ports, according to the tender specifications these were advertised as follows:

(i) alternative 1: Daily sailing throughout the year;

(ii) alternative 2: Sailings 7 days a week in summer (8 months), 5 days a week in winter (4 months); and

(iii) alternative 3: Sailings 5 days a week throughout the year.

(110) The tender specifications stress in 2.14: '[t]he choice will be made on the basis of an assessment of the price level of the different alternatives compared with the differences in frequency the different alternatives represent. Once an alternative has been selected, the contracting authority will choose the tender that offers the lowest price for the entire contract term (at 2011 prices)'. The tender specifications further specify in detail certain qualitative standards to be met by all economic operators, irrespective of the alternative selected.

([1]) Application of the State aid rules to compensation granted for the provision of services of general economic interest (OJ L 161, 13.6.2013, p. 12 (Annex I) and EEA Supplement No 34, 13.6.2013, p. 1), paragraph 68. In this context, in the past, the Commission has reported that, in order to exclude State aid, the amount of compensation for the discharge of PSOs should correspond to the market price, where the relevant market is an effectively contestable market with a sufficient number of potential bidders (see European Commission, Non-Paper on services of general economic interest and state aid, 12.11.2002, paragraph 87).

([2]) For background information on the Hurtigruten Agreement, see Decision No 205/11/COL on the Supplementary Agreement on the Hurtigruten service, section 2 (OJ L 175, 5.7.2012, p. 19, and EEA Supplement No 37, 5.7.2012, p. 1).

([3]) See the Authority Decision No 417/01/COL of 19 December 2001 on compensation for maritime transport services under the 'Hurtigruten Agreement', available at http://www.eftasurv.int

([4]) Until 2006, the service was operated by two maritime companies, Ofotens or Vesteraalens Dampskipsselskap ASA and Troms Fylkes Dampskipsselskap. The two companies merged in March 2006 to form Hurtigruten, which now operates the service.

(111) It could be argued that potential bidders were not excluded from choosing any of the mentioned alternatives with the use of non-cost criteria and that the contracting authority had in any case invited openly bidders to select any alternative in knowledge of the fact that the chosen tender would be the one offering the lowest price for the entire contract term.

(112) However, given the history of the service concerned and the broad terms of the contract, which, given the circumstances, pointed towards the first alternative model of sailing (the one finally chosen) and the selection of Hurtigruten, other potential bidders might have been discouraged from participating even with the choice of another alternative (although the variations amongst the different alternatives were not material), even though the contracting authority showed no direct preference for the first alternative ([1]).

(113) The Authority therefore notes that the public procurement process as designed (including also for the previous contract periods), although it did not unjustifiably and directly exclude any potential bidders, did not attain the widest possible opening-up to genuine competition ([2]). This may take measures such as a more limited entrustment in terms of duration or scope, or separate entrustments, for example by unbundling the route into different stretches or day schedules, and in combination with the extension of the time-limit from the deadline for submitting bids until the service start-up date.

(114) As a result, the outcome produced with only one bid being submitted cannot be considered adequate to reflect competitive market conditions.

(115) The Authority thus concludes that the public procurement process, where only Hurtigruten's bid was submitted, is not deemed sufficient to ensure 'the least cost to the community'.

(116) Concerning the second limb of the fourth *Altmark* condition, the Norwegian authorities did not submit any information to demonstrate that the compensation granted was established on the basis of an analysis of the cost of a typical undertaking.

(117) As a result, in view of the above, the Authority observes that the fourth *Altmark* condition is not fulfilled.

(118) Since the four *Altmark* conditions are to be assessed cumulatively, it is consequently not necessary to examine the second and third conditions.

1.2.3. ***Conclusion on the Altmark conditions***

(119) The Authority concludes that the compensation awarded under the HA does not comply with all the four conditions in the *Altmark* judgment. The Authority thus concludes that an advantage within the meaning of Article 61(1) EEA has been granted to Hurtigruten for performing the service concerned.

2. *CONCLUSION ON THE PRESENCE OF AID*

(120) The Authority finds that the compensation awarded under the HA entails State aid within the meaning of Article 61(1) of the EEA Agreement.

3. *PROCEDURAL REQUIREMENTS*

(121) Pursuant to Article 1(3) of Part I of Protocol 3: '[t]he EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. […] The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision'.

(122) The Norwegian authorities did not notify the HA to the Authority. The Authority therefore concludes that the Norwegian authorities have not respected their obligations pursuant to Article 1(3) of Part I of Protocol 3, without prejudice to the application of the SGEI Decision.

([1]) In fact, according to the information submitted, the company Boreal/Veolia Transport had put forward questions during the Q&A process of the procurement procedure and was considering participating.

([2]) Judgment in *CoNISMa*, C-305/08, EU:C:2009:807, paragraph 37; Judgment in *Assitur*, C-538/07, EU:C:2009:317, paragraph 26.

3.1. APPLICABILITY OF THE SGEI DECISION ([1])

(123) The SGEI Decision lays down the conditions under which certain types of public service compensation are to be regarded as compatible with the functioning of the EEA Agreement pursuant to its Article 59(2) and exempt from the requirement of prior notification under Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement.

(124) There is one exception from the notification requirement of Article 2 of the SGEI Decision, which might be relevant in the present case:

'(d) compensation for the provision of services of general economic interest as regards air or maritime links to islands on which the average annual traffic during the 2 financial years preceding that in which the service of general economic interest was assigned does not exceed 300 000 passengers';

(125) According to the information submitted, the threshold of 300 000 passengers has been exceeded.

(126) Consequently, the SGEI Decision cannot be applied.

4. *COMPATIBILITY OF THE AID*

4.1. THE LEGAL FRAMEWORK

(127) The compatibility of public service compensation for maritime transport is assessed on the basis of Article 59(2) of the EEA Agreement in conjunction with the Authority's Framework ([2]).

(128) The principles set out in the Framework apply to public service compensation only in so far as it constitutes State aid not covered by the SGEI Decision.

(129) According to the case-law of the Court of Justice, it is up to the Member State to invoke possible grounds for compatibility and to demonstrate that the conditions of compatibility are met ([3]).

4.2. APPLICABILITY OF THE FRAMEWORK

(130) The compatibility of the HA shall be assessed against the following conditions as provided for by the Framework:

(a) genuine SGEI;

(b) entrustment act and period of entrustment;

(c) amount of compensation and absence of overcompensation;

(d) no affectation of trade development to an extent contrary to the interests of the EEA.

(131) The Framework further comprises certain other conditions, such as compliance with EEA public consultation to take account of the public service needs (paragraph 14), public procurement rules (paragraph 19), absence of discrimination (paragraph 20), the use of net avoided cost methodology (paragraph 24), efficiency incentives (paragraph 39) and transparency (paragraph 60) that need to be fulfilled for a compensatory measure to be compatible with Article 59(2) of the EEA Agreement.

(132) As mentioned in paragraph 69 of the Framework, '[t]he Authority will apply the principles set out in this Framework to unlawful aid on which it takes a decision after 31 January 2012 even if the aid was granted before this date. However, where the aid was granted before 31 January 2012, the principles set out in paragraphs 14, 19, 20, 24, 39 and 60 do not apply'.

([1]) Decision 2012/21/EU incorporated at point 1h of Annex XV of the EEA Agreement.
([2]) Framework for State aid in the form of public service compensation, OJ L 161, 13.6.2013, p. 12 (Annex II) and EEA Supplement No 34, 13.6.2013, p. 1.
([3]) Judgment in *Italy* v *Commission*, C-364/90, EU:C:1993:157, paragraph 20.

(133) As the HA entered into force on 13 April 2011 and specified the entire amount of compensation for the duration of the contract period upfront, subject only to an annual indexation adjustment, the above mentioned conditions in paragraph (131) are not applicable, because the aid was granted before 31 January 2012.

4.2.1. ***Genuine SGEI***

(134) As set out in paragraphs (84) to (102), the HA requiring a minimum reserve capacity constitutes a genuine SGEI.

(135) It is, however, necessary to examine whether the other conditions of the Framework are met for the HA.

4.2.2. ***Entrustment act***

(136) The HA specifies in detail the obligations of the public service, the undertaking that carries out the service and the territory concerned.

(137) Further, one of the compatibility conditions that must be fulfilled, as indicated in paragraph 16 of the Framework, is that the entrustment act shall include '[…] (d)[a] description of the compensation mechanism and the parameters for calculating, monitoring and reviewing the compensation'.

(138) The compensation is calculated on the basis of the parameters specified in Annex D to the tender specifications together with the applicable allocation keys to differentiate between the SGEI and commercial activities ([1]). Annex D provides the following:

Table 2

The parameters in the budget scheme for the public service ([1])

A:	Total revenues distance passengers
B:	Passengers cost distance passengers
C:	Net passenger revenues (A+B)
D:	Revenues from on board sales
E:	Net revenues from goods and cars
F:	Other revenues
G:	Total own revenues (C+D+E+F)
H:	Government procurement of service
I:	Total revenue (G+H)
J:	Safety crew
K:	Oil and fuel
L:	Repairs and maintenance
M:	Port costs
N:	Insurance costs
O:	Depreciation own vessels/bareboat
P:	Net financial costs
Q:	Total capacity costs (J+K+L+M+N+P)
R:	Cost of goods sold
S:	Crew not included in the safety crew
T:	Marketing costs and sales provision

([1]) From Annex C of the tender specifications it follows that the costs of the coastal route are divided into capacity and passenger costs, with each cost category having a separate allocation key. The capacity cost distribution formula has been calculated by determining the ratio of the number of passenger kilometers required through the government procurement agreement, and Hurtigruten's actual passenger kilometer capacity. The passenger cost distribution formula has been calculated by determining the ratio between the number of passenger kilometers expected for distance travellers and the number of passenger kilometers for other travelers.

U: Administration costs

V: Other costs

W: Total passenger costs (R+S+T+U+V)

X: Total costs public service (Q+W)

Y: Net result before taxes (I-X)

([1]) The Norwegian authorities have confirmed that these parameters do not include the expected refunds derived from the Seafarers Tax Refund Scheme (see EFTA Surveillance Authority Decision No 085/16/COL raising no objections to the tax refund scheme for employing seafarers 2016–2026, available at: http://www.eftasurv.int/media/esa-docs/physical/085-16-COL.pdf).

(139) Hurtigruten, in compliance with the tender specifications, has established a separate budget incorporating all costs and revenues attributable to the PSO route (using 2011 prices, adjusted in accordance with Statistics Norway's cost index). According to section 4.9.2 of the tender specifications, this separate accounting aims at ensuring predictability for which costs and revenues can form the basis of any renegotiation, as provided for in sections 6 and 7 of the HA ([1]). A further aim is to document that the public procurement process does not entail any unlawful cross-subsidisation between the PSO services and the commercial services.

(140) As mentioned in the opening decision, the HA has fixed the annual compensation to be paid for the maritime services for each individual year from 2012 to 2019 based on a minimum capacity reserve and costs allocated on the basis of an estimated share of PSO passenger kilometres per year. This amount has been based on the cost categories of Annex D, as illustrated above in table 2, and subsequent negotiations. These negotiations resulted in a reduction of the compensation relative to the initial offer by Hurtigruten ([2]).

(141) As regards section 4-1, item 3 of the HA, which provides that '[o]mission of up to 10 days of operation in agreed production per ship per annum due to planned maintenance and unforeseen operational disruption linked to agreed production (off-hire) is considered to be proper fulfilment and shall not entail a deduction in the agreed remuneration in accordance with section 9-2', the Authority notes that the ceiling of 10 days (110 days per year for the fleet) has been based on documented evidence over the preceding years, which confirms the need for at least 110 operating days per year for planned maintenance and unforeseen operational disturbances. Further, this parameter had been included in the draft agreement in the tender documents and remained unchanged in the final agreement.

(142) Concerning sections 6 and 7 of the HA, the Authority notes that both sections contain certain provisions on the adjustment of compensation in case of changes in production or in case of unforeseen events.

([1]) Section 6 reads: 'Both parties may request negotiations over production changes during the contract period. The changes must not be considered significant and may involve increases or reductions in production, quality or capacity changes, or addition or elimination of single ports of call. Changes may apply to the rest of the contract period or for shorter periods. The remuneration shall be adjusted according to costs and revenues flowing from the changes. Distribution of costs and revenues shall be based on accounting separation'. Section 7 reads: 1. 'In the event of amendments to acts, regulations or statutory orders which the parties could not have reasonably foreseen on signing the contract and which entail material extra costs or savings for the contract for the public procurement of the service, each of the parties may demand negotiations concerning extraordinary adjustment of the remuneration from the contracting authority, a change to production or other measures […]. Accounting separation shall form the basis of any renegotiation of the contract. It is considered to be of material significance for the party when it constitutes more than 5 % of the annual agreed remuneration for the year in question […].'

([2]) The negotiations also led to certain changes incorporated to the draft tender contract, see HA, section 4.1 third paragraph (route production requirements), section 7 (renegotiations), section 8 (*force majeure*) and section 9.2 (non-performance in production).

(143) In this context, as the EFTA Court pointed out in the *Hurtigruten* case: '[i]t is only logical that the assessment of State aid granted under the renegotiation clause in a public service contract, such as Article 8 of the 2004 Agreement, gives due consideration to whether the parameters of the contract as a whole are established in an objective and transparent manner, since the clause is an inherent part of the public service contract' ([1]).

(144) The EFTA Court also emphasised that the principle of transparency must always be observed: '[…] Norway could, if necessary, have made provision, in the notice of invitation to tender, for the possibility of amending the conditions for payment of the successful tenderers in certain circumstances by laying down in particular the precise arrangements for any supplementary compensation intended to cover unforeseen losses and costs' ([2]).

(145) The Authority considers that the HA describes adequately the compensation mechanism and defined the parameters of the compensation in an objective and transparent manner by establishing a separate budget, which, incorporated all costs and revenues attributed to the PSO routes and precludes thus any abusive recourse to the concept of the SGEI ([3]), as illustrated above. Therefore, as regards the provisions on the adjustment of compensation in case of changes in production or in case of unforeseen events included in sections 6 and 7 of the HA, it should be stressed that neither of these provisions alter significantly the compensation mechanism, nor do they call into question its parameters.

(146) Moreover, point (e) of paragraph 16 of the Framework mentions that the entrustment act must include 'the arrangements for avoiding and recovering any overcompensation'.

(147) In the opening decision, the Authority did not exclude that Hurtigruten might have been overcompensated for the provision of the public service, due to the fact that among others the HA does not contain any clawback clause, such that if any agreed profit margin is exceeded, the surplus must be returned to the State or deducted from the compensation paid in the next year or perhaps over the contract period ([4]). The Norwegian authorities have indeed confirmed that the HA does not include any such concrete arrangements, apart from the renegotiation provision of paragraph 7 of the HA, which can, to an extent, lead to avoidance and recovery of overcompensation.

(148) The complainants have also pointed to the lack in the HA of a compensation cap that would ensure that any overcompensation is avoided.

(149) The Authority no longer has doubts regarding the lack of such arrangements in the HA. Although an inclusion in the entrustment act of a procedure for recovering any overcompensation adds to the objectivity and transparency of the process, it follows from the Framework that this is not strictly necessary: '[w]here the EFTA State has defined upfront a fixed compensation level which adequately anticipates and incorporates the efficiency gains that the public service provider can be expected to make over the period of the entrustment, on the basis of a correct allocation of costs and revenues and of reasonable expectations […], the overcompensation check is in principle confined to verifying that the level of profit to which the provider is entitled in accordance with the entrustment act is indeed reasonable from an *ex ante* perspective' ([5]).

(150) The HA is based on the definition of a total compensation that is granted upfront for the whole duration of the agreement and is reduced over time, with the effect of continuously inducing the company to improve its efficiency in order to receive the same real economic result from the contract over time.

(151) The Authority nevertheless takes note of the Norwegian authorities' plans to incorporate such a clawback mechanism in the future PSO contract regarding the maritime services for the Bergen – Kirkenes route. This will help ensure that any aid granted in the future is not incompatible and subject to recovery.

([1]) Judgment in E-10/11 and E-11/11 *Hurtigruten* [2012] EFTA Ct. Rep. 758, paragraph 122.
([2]) Judgment in E-10/11 and E-11/11 *Hurtigruten* [2012] EFTA Ct. Rep. 758, paragraph 127.
([3]) See in this context: Judgment in *Coordination bruxelloise d'institutions sociales et de santé (CBI)* v *European Commission*, T-137/10, EU: T:2012:584, paragraph 191.
([4]) Opening decision, paragraph 75.
([5]) OJ L 161, 13.6.2013, p. 12 (Annex II) and EEA Supplement No 34, 13.6.2013, p. 1, paragraph 50.

4.2.3. ***Period of entrustment***

(152) The period of the entrustment of seven years is in accordance with the requirement of the Framework and the Maritime Cabotage Regulation ([1]).

4.2.4. ***Amount of compensation and absence of overcompensation***

(153) According to paragraph 21 of the Framework, '[t]he amount of compensation must not exceed what is necessary to cover the net cost of discharging the public service obligations, including a reasonable profit'.

(154) Paragraph 23 of the Framework states that '[w]here the compensation is based [as in the case at hand], in whole or in part, on expected costs and revenues, they must be specified in the entrustment act. They must be based on plausible and observable parameters concerning the economic environment in which the SGEI is being provided […]'.

(155) Further, as mentioned above under paragraph (149), in cases, as the one at hand, of upfront definition of a fixed compensation level, the Framework limits the overcompensation check to verifying that the level of profit is reasonable from an *ex ante* perspective.

(156) Lastly, under paragraph 44 of the Framework '[w]here an undertaking carries out activities falling both inside and outside the scope of the SGEI, the internal accounts must show separately the costs and revenues associated with the SGEI and those of the other services in line with the principles set out in paragraph 31'.

(157) In view of the above, the Authority will firstly assess the complainant's arguments and then consider whether the HA leads to overcompensation either through possible cross-subsidisation of the commercial activities or by retaining an excessive profit.

4.2.4.1. The complainants' arguments

(158) Briefly, according to the complainants' arguments, presented in further detail in paragraph (16) above:

(i) Hurtigruten does not reserve capacity for public service passengers, but rather sells the capacity to cruise passengers, while maintaining the public service compensation at the same level;

(ii) the compensation for providing the public service has increased substantially as compared to the previous contract period;

(iii) Hurtigruten continues receiving compensation for services that are not rendered; and, lastly

(iv) Hurtigruten further attempts to get lower prices for the harbour fees, while maintaining the public service compensation at the same level.

(159) As regards the first point, pursuant to paragraph 21 of the Framework, only the costs incurred in discharging the PSO shall be covered for compensation payment. That said, any compensation granted to cover costs outside the public service remit cannot be held to constitute compensation for PSO.

(160) In the opening decision, the Authority stated that when the capacity (passengers and berth) for PSO passengers is sold to commercial cruise passengers, Hurtigruten is apparently paid twice for the same service, which would in principle constitute a form of overcompensation. As a result, given that there might be periods of the year where capacity utilisation for public service passengers was higher, the Authority could not rule out that the mechanism used in the HA overcompensates Hurtigruten in that it does not take into account different (e.g. seasonal) levels of capacity utilisation during the year ([2]).

([1]) See also Communication from the Commission 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), COM(2014) 232 final, 22.4.2014, section 5.5.2.

([2]) Paragraphs (65)-(66).

(161) As has already been stated above under section 1.2.1, the objective of the HA is to ensure that there is sufficient capacity to meet the demand of the PSO passengers throughout the year along the Bergen – Kirkenes coast line. If there is spare PSO capacity, the HA, which is a net contract, does not unjustifiably prohibit Hurtigruten from selling tickets to cruise passengers, as long as the public service is not jeopardised.

(162) It is also acknowledged and accepted as part of the SGEI definition, that the capacity utilisation can, by the nature of the service in question, have substantial regional and seasonal variations with the inevitable result of the vessels, in particular in off-peak periods, having free capacity within the minimum requirements set in the HA.

(163) The Norwegian authorities have submitted and documented that Hurtigruten has a fairly low utilisation of the ship capacity ([…] %). Therefore, in the vast majority of cases there is free PSO capacity that could potentially be sold to commercial passengers, if needed (see above under section 5.3, first BDO report 2016). However, as explained by the Norwegian authorities, the implication of the capacity reserve is that Hurtigruten does not have the opportunity to optimise its operations and maximise its profits, for example by redeploying vessels elsewhere during off-peak periods.

(164) It is also submitted that only in rare cases have PSO passengers not been able to get a ticket within the minimum capacity reserve. Nevertheless, according to the Norwegian authorities, this has been compensated by the use of the travel guarantee [1].

(165) Although the use of the travel guarantee for PSO passengers that have not been able to get a ticket within the minimum capacity reserve does not fully satisfy the requirements of the PSO assigned, this cannot be held to have led to any overcompensation above the reasonable profit level.

(166) Concerning the second point, the Authority stresses that in assessing whether the current HA leads to overcompensation, it shall take into account all the costs necessary to operate the specific public service as well as the entire revenue earned. This assessment is carried out irrespective of compensatory payments made during previous contract periods [2].

(167) As highlighted above under paragraphs (136) to (151), the entrustment act, that is to say the HA, describes in detail the parameters of compensation, as well as the account separation methodology, with separate allocation keys for the different cost categories, distinguishing between costs and revenues of the SGEI and the commercial activities, which result in a net compensatory amount before taxes.

(168) Therefore, the Authority concludes that the substantial increase in the compensation compared to the previous contract period does not, in and of itself, imply overcompensation, if all relevant costs and revenues are taken into account, save for possible cross-subsidisation or excessive profit, which the Authority assesses below under sections 4.2.4.2 and 4.2.4.3.

(169) In relation to the argument that Hurtigruten continues receiving compensation for services that are not rendered, the Authority does no longer consider that there is a risk of overcompensation. It thus accepts the Norwegian submissions mentioned above under paragraphs (51) to (54).

(170) Concerning the last point on Hurtigruten's attempts to negotiate lower port fees whilst the Norwegian authorities maintain the compensation at the same level, it must be stressed that in net contracts like this, where the operator carries the risk of costs and revenues over the entire contract period, the Authority is confined to assess whether there is any overcompensation above the level of a reasonable profit (see below section 4.2.4.3).

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[1] See paragraph (49).

[2] The Norwegian authorities had paid Hurtigruten a total compensation of NOK 1 899,7 million to carry out the same PSO routes during the period 2005-2012. More specifically, the annual compensation for the year 2011 amounted to NOK 236,8 million. See the Authority's Decision No 205/11/COL on the Supplementary Agreement on the Hurtigruten service (OJ L 175, 5.7.2012, p. 19, and EEA Supplement No 37, 5.7.2012, p. 1), section 2.

4.2.4.2. Possible cross-subsidisation of commercial activities

(171) When an entity carries out both SGEI and commercial activities, a cost-accounting system should be in place to ensure that the commercial activities of Hurtigruten are not subsidised through the public service compensation allocated to its SGEI activities.

(172) Under paragraph 31 of the Framework '[w]here the undertaking also carries out activities falling outside the scope of the SGEI, the costs to be taken into consideration may cover all the direct costs necessary to discharge the public service obligations and an appropriate contribution to the indirect costs common to both the SGEI and other activities. The costs linked to any activities outside the scope of the SGEI must include all the direct costs and an appropriate contribution to the common costs.'

(173) Further, the Court of Justice in the *BUPA* judgment, in reference to the necessity and proportionality of the compensation, stated that '[…] [g]iven the discretion enjoyed by a Member State in defining an SGEI mission and the conditions of its implementation, including the assessment of the additional costs incurred in discharging the mission, which depends on complex economic facts, the scope of the control which the Commission is entitled to exercise in that regard is limited to one of manifest error […]' and that '[…] the Commission's review […] is necessarily limited to ascertaining whether, first, the system in question is founded on economic and factual premises, which are manifestly erroneous and whether second, the system is manifestly inappropriate for achieving the objectives pursued' ([1]).

(174) It was mentioned above in paragraph (94) that around 60 % of Hurtigruten's share of fixed capacity costs is covered by the public service compensation, whereas only approximately 30 % of the variable passenger costs had been allocated to the PSO account (based on estimated PSO passenger kilometres figures). The question therefore for the Authority to assess is whether the system under which the reserve capacity for PSO passengers (i.e. 320 passengers) leads to the allocation of 60 % of fixed capacity costs to the PSO account, is considered disproportionate and inappropriate for achieving the objectives pursued.

(175) The Norwegian authorities have implemented an allocation methodology based on a distribution formula for the different cost categories as explained in paragraphs (64) and (65) above.

(176) In particular, when it comes to fixed common costs, these are allocated according to the share of total passenger capacity reserved for PSO passengers.

(177) The Authority has already accepted this minimum capacity reserve as being part of a clearly defined SGEI, despite the low average capacity utilisation of the public service (see above under section 1.2.1). In addition, it has been considered that within the remit of such an SGEI, regional and seasonal fluctuations are inevitable, and as a result, it is also inevitable that a significant part of the cost base, which largely comprises fixed costs, would be allocated to the PSO account.

(178) It must moreover be underlined that the accounting system implemented by Hurtigruten, as illustrated above in paragraphs (138), (139), (144) and (145), allows to identify the different costs and revenues for the PSO and the commercial activities. This is done in an objective and transparent manner by establishing the parameters of the compensation beforehand in separate accounts distinguishing thus between the different cost categories in order for the final compensation to reflect only the costs and revenues stemming from the PSO activity.

(179) In view of the above, the Authority concludes that the cost allocation seems, in light of the SGEI definition, acceptable and that there is insufficient evidence suggesting that the allocation of fixed common costs is manifestly erroneous allowing for cross-subsidisation of the commercial activities.

([1]) Judgment in *British United Provident Association Ltd (BUPA), BUPA Insurance Ltd and BUPA Ireland Ltd* v *Commission of the European Communities (BUPA)*, T-289/03, EU:T:2008:29, paragraphs 220 and 222.

4.2.4.3. Reasonable profit

(180) The Authority must assess whether the rate of return on capital is in line with '[…] what would be required by a typical company considering whether or not to provide the service for the whole duration of the entrustment act, taking into account the level of the risk […]' (paragraph 33 of the Framework).

(181) In its opening decision, the Authority expressed doubts concerning the methodology used by the Norwegian authorities to calculate that Hurtigruten's profit margin from the HA represented […] % ([1]).

(182) According to paragraph 37 of the Framework, '[w]here the provision of the SGEI is connected with a substantial or contractual risk, for instance because the compensation takes the form of a fixed lump sum payment covering expected net costs and a reasonable profit and the undertaking operates in a competitive environment, the reasonable profit may not exceed the level that corresponds to a rate of return on capital that is commensurate with the level of risk. That rate should be determined where possible by reference to the rate of return on capital that is achieved on similar types of public service contracts awarded under competitive conditions (for example, contracts awarded under a tender). Where it is not possible to apply that method, other methods for establishing a return on capital may also be used, upon justification'.

(183) In the course of the investigation, the Norwegian authorities submitted more information on the financial evaluations carried out before the tender invitation was published, describing the estimates on expected costs and revenues, as well as projections for a rate of return on capital. They submitted that the […] % EBT figure does not represent a rate of return but is the residual result of the agreed compensation in relation to the budgeted costs and revenues and not appropriate to use as a measure for reasonable profit.

(184) According to these *ex ante* evaluations performed by BDO (see above under section 5.4), the rate of return was presented as a WACC after tax and was expected to be within an interval (but in the upper part) of […] % to […] %. These results were thereafter used to evaluate Hurtigruten's bid and prompted the Norwegian authorities to enter into negotiations with the company, which resulted in a reduction of the compensation. The agreed compensation was considered to produce a ROCE of around […] %, based on Hurtigruten's estimated costs and revenues, as presented in the tender. This figure has been reviewed and substantiated by the second BDO report of 2016, which found that the *ex ante* estimated return of […] % was within the range of the relevant benchmarks and that that the actual average ROCE on the PSO contract from 2012-2015 is […] % (see above paragraphs (73) and (74)).

(185) In light of the above (i.e. the *ex ante* analysis of ROCE by comparing it with the WACC, the use of an appropriate discount rate and the benchmarking analysis with other cruise operators), the Authority regards the expected profit agreed *ex ante* as a reasonable level for this type of activity, considering, inter alia, the risks involved (e.g. large fixed cost base, low income, additional costs from potential production deviations etc.).

(186) Furthermore, the profit margin foreseen was the result of a public procurement process (including negotiations), which, although it did not allow for the selection of an operator capable of providing the maritime service at the least cost to the community, took account of certain safeguards against overcompensation for the performance of the PSOs ([2]).

4.2.5. ***Additional requirements which may be necessary to ensure that the development of trade is not affected to an extent contrary to the interests of the EEA***

(187) The Authority takes note of the fact that the Norwegian authorities organised a tender process for the selection of the service provider to operate the Bergen – Kirkenes coastal route for the period 2012-2019. Although the tender produced only one bid, there is no indication that this process has resulted in any distortions of competition in the maritime transport sector, neither has the Authority received any such allegations from relevant competitors.

([1]) Paragraph 59.

([2]) Although the public contract does not include a clawback mechanism, which is generally the preferred mechanism to ensure that any potential excess compensation is returned to the Norwegian authorities, the renegotiation provision of paragraph 7 of the HA does help, at least to a certain extent, to avoid and recover such overcompensation.

(188) It is further observed that the compensation for the HA does not allow the operator to cross-subsidise its commercial activities through, for example, a manifestly disproportionate allocation of the fixed common costs, nor does it allow the operator to do so by obtaining an excessive profit. Instead, the HA only covers the costs of the public service including a reasonable profit.

(189) The Authority therefore does not find it required to impose additional conditions to ensure compatibility of the HA with the EEA Agreement but, nevertheless, invites the Norwegian authorities to consider its recommendation indicated in paragraph (113).

5. *CONCLUSION*

(190) In the light of the above, the Authority considers that the compensation received by Hurtigruten under the HA constitutes compatible aid under Article 59(2) of the EEA Agreement,

HAS ADOPTED THIS DECISION:

Article 1

The compensation paid under the HA constitutes State aid pursuant to Article 61(1) of the EEA Agreement. That aid was granted in breach of the notification obligation pursuant to Article 1(3) of Part I of Protocol 3.

Article 2

The compensation granted under the HA is considered compatible on the basis of Article 59(2) of the EEA Agreement.

Article 3

This Decision is addressed to the Kingdom of Norway.

Article 4

Only the English language version of this decision is authentic.

Done at Brussels, 29 March 2017.

For the EFTA Surveillance Authority

Sven Erik SVEDMAN	For Frank J. BÜCHEL
President	*College Member*