

## Gourock-Dunoon Ferry Service Future Contract

### Service requirement

1. The Scottish Government has set out its policy position in the 2012 Ferries Plan:

*“The Scottish Government’s policy position is unchanged: we would like to see a vehicle and passenger ferry service on the town centre route.”<sup>1</sup>*

2. The European Commission (EC) confirmed in their Decision of October 2009<sup>2</sup> that:

*“The winning bidder will be allowed to provide an unrestricted commercial vehicle transport service, subject to appropriate accountancy measures and audit monitoring to prevent cross subsidisation from the passenger service to the commercial vehicle service”.*

And that<sup>3</sup>

*“However, the Commission considers that in principle it is possible in the future to legitimately define a SGEI<sup>4</sup> for passenger transport on this route, including the possibility to carry out commercial activities on the basis of a combined passenger/vehicle vessel. This would not per se constitute a manifest error, provided that its characteristics are precisely defined in a legal Act.”*

3. Under the terms of the EC Decision, only passengers travelling on this route can be subsidised<sup>5</sup> and the Scottish Government has therefore proceeded since October 2009 on the basis that it can only advertise and contract for a passenger service; a vehicle-carrying service would have to be provided by the operator at their own volition and at their own commercial risk.

4. At the request of the Steering Group, exchanges have taken place with EC officials on whether the next operator could be required to carry vehicles at their own commercial risk. The EC have responded (see Annex B) that Member States may impose a Public Service Obligation (PSO) or conclude a Public Service Contract (PSC) only if they have determined that the transport service in question would be inadequate if its provision was left to market forces alone; and that the PSO or PSC must be necessary and proportionate to the aim of ensuring the adequacy of transport services.

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<sup>1</sup> ‘Scottish Ferry Services – Ferries Plan (2013-2022)’ page 24, paragraph 50

<sup>2</sup> ‘Commission Decision of 28.10.09 on State Aid ... Subsidies to CalMac and NorthLink for maritime transport services in Scotland’ paragraph 153(e)

<sup>3</sup> ibid paragraph 280

<sup>4</sup> Service of General Economic Interest

<sup>5</sup> Commission

Decision paragraph 153(d)

5. This is consistent with the EC Decision and with the Commission's more recent Communication on Services of General Economic Interest<sup>6</sup>:

*"48. The Commission thus considers that it would not be appropriate to attach specific public service obligations to an activity which is already provided or can be provided satisfactorily and under conditions, such as price, objective quality characteristics, continuity and access to the service, consistent with the public interest, as defined by the State, by undertakings operating under normal market conditions. As for the question of whether a service can be provided by the market, the Commission's assessment is limited to checking whether the Member State has made a manifest error."*

6. Member States have wide margin in discretion in defining an SGEI and PSOs subject to the Commission's assessment of whether this constitutes a "manifest error"

7. The view of the Dunoon Gourock Ferry Action Group (see Annex C, paragraph 2.1) is that:

*"the Scottish Government would not be committing a 'manifest error' if it were to seek to restore a vehicle carrying service... by requiring that future services should carry vehicles".*

8. In their analysis of the Commission's most recent response (see Annex C), DGFAG have noted that (not an exhaustive list):

- Western Ferries' timetable "makes use of at most 3 ferries" and the loss of the Cowal Ferries' hourly service on the town centre route has removed the "high degree of certainty of getting on the next sailing" of either service; and that this "undermines the viability of Cowal as a location from which people can commute by vehicle" as it requires users to catch a ferry 20 minutes earlier than previously".
- A public inquiry in 1992 concluded that many businesses in Dunoon would suffer hardship if the vehicle ferry service was removed from the town centre due to reliance on passing trade. More recently, Dunoon, with Campbeltown, has been ranked as Scotland's most vulnerable town<sup>7</sup>;
- The "removal of a transport route results in a loss of traffic, with an 11% loss being a rough and probably conservative guide"<sup>8</sup>.
- In terms of market need, the MVA study concluded that a new town centre vehicle service, using 2 vessels, would be able to capture the majority (56%) of vehicle traffic. For DGFAG, *"the clear implication of that is that currently the*

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<sup>6</sup> Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest of 11.1.2012 (2012/C 8/02)

<sup>7</sup> Reference included in the DGFAG paper (Annex C to this paper, paragraph 10)

<sup>8</sup> Reference included in the DGFAG paper (Annex C to this paper, paragraph 10)

*majority of vehicle traffic is being disadvantaged, by being forced to take its least preferred route, to the advantage of the private operator”.*

9. The view of the Scottish Government is that a requirement to provide a vehicle-carrying service, without subsidy and at the commercial risk of the operator, would be highly likely to be deemed by the Commission to be a manifest error. This is for the following reasons:

- the various communications from the Commission make clear that a future operator cannot be required to provide a vehicle-carrying service just because that is the policy of the Scottish Government and/or the predicted preferred route of a large number of users (56% according to the MVA study);
- a requirement to provide a vehicle-ferry service would exclude bids from operators wishing to provide a passenger-only service. This is likely to be a breach of procurement law;
- if a vehicle-carrying service could be considered an SGEI then it would, in principle, be eligible for subsidy (subject to compliance with State aid rules). However the EC Decision is clear that only passengers can be subsidised on the town centre service;
- in order to justify that a vehicle-carrying service was an SGEI, the Scottish Government would need to conclude that the vehicle-ferry service provided by Western Ferries is “inadequate”;
- the Commission have commented in their letter of 12 February 2015 (see Annex) that:

*“Based on the information provided to us it seems that the vehicular service is sufficiently provided by the market and therefore there is no need to establish a PSO/PSC”<sup>9</sup>.*

*[we may get further reaction from the EC before the 5 May meeting]*

### Options

10. The options set out in the Steering Group paper GDSG 2014/2/4 can be expanded to three:

- (1) tender for a passenger only subsidy and encourage bidders to provide an unsubsidised vehicle-carrying service at their own commercial risk;
- (2) specify a passenger-only service;
- (3) tender for a vehicle-passenger service with only the passenger element subsidised.

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<sup>9</sup> Western Ferries operate 40+ timetabled return sailings per day from 0610 – 2230 (2400 at weekends) and also provide a 24-hour ‘blue light’ service. Crossing time is 20 minutes.

## Risks

11. Paper GDSG 2014/2/4 compared the pros and cons of the first 2 options. The following is our assessment of the risks around option 3.

- The likelihood of the complaint to the EC (and potentially a legal challenge in the courts) is considered by the Scottish Government to be **high**. This would most likely be a challenge based on a breach of procurement law (see paragraph 9).
- The probability of success of such a complaint is considered to be **high**.
- The impact of a successful challenge is considered to be **high** (see below).
- The likelihood of no operator coming forward to bid when required to provide a vehicle-carrying service at their own risk is considered to be **moderate**;
- If a contract and service went ahead without successful challenge, and assuming that the successful bidder had acted with due diligence, the risk that the vehicle ferry service would fail to at least break-even is considered to be **low**. However, the impact if this risk materialised is considered to be **high** as it would put the whole contracted service, including the subsidised passenger element, at risk of default and premature termination.

## Consequences

12. Depending on the timing of an EC or Court decision (e.g. before contract award, before or after service commencement) the consequences could include:

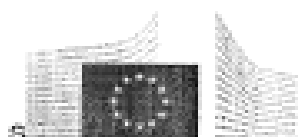
- The suspension or cancellation of the tendering exercise
- The termination of shipbuilding contracts, with financial penalties
- The repayment of subsidies paid to the service operator
- Compensation claims from the successful and unsuccessful bidders

13. Further indirect consequences could include:

- Significant reputational damage to the Scottish Ministers and to the members of the Steering Group;
- Potentially, a reopening of the Commission's 2009 Decision and a renewed threat to the continuation of a passenger subsidy.

## **Annex A**

See separate DGFAg paper: "Dunoon Gourock ferry tender: Community response to questions posed by the European Commission"



**EUROPEAN COMMISSION**

DG Competition

Markets and cases V: Transport, post and other services  
**State aid transport**

Brussels, 12.02.2015

COMP/F2/JS/11\*1D- 2015/012133

Permanent Representation of the  
 United Kingdom of Great Britain  
 and Northern Ireland to the  
 European Union  
 Avenue d'Auderghem, 10  
 1040 Bruxelles

**Subject: State aid SA.36089 - 2013/CP - Alleged subsidies granted for the  
 Gourock-Dunoon route**

Dear Sir or Madam,

Thank you for your recent correspondence by email (of 7, 16 and 22 January 2015) in response to our letter of 2 September 2014, in relation to a possible future Gourock-Dunoon ferry service. This correspondence and letter linked to various previous correspondence with regard to the State aid complaint cited in the subject above.

You supplied information to us from the Dunoon Gourock Ferry Action Group (DGFAG) on the necessity of having a vehicle service as part of the tender for a future ferry link. You also put forward suggestions as to how costs might be allocated between a subsidised foot passenger element, and the unsubsidised commercial vehicle carrying element of the service.

In response, may we first reiterate the various detailed points about a future service made in our letter of 2 September 2014, and add the further points below. This answer below is joint preliminary response from services of DG COMP and DG MOVE and not the formal position of the Commission. We hope it reflects a high level summary of the key points discussed in our recent teleconference of 27 January 2015.

With regard to the necessity of having a vehicle service as part of the future ferry link we would like to reiterate that EC Regulation 3577/92 on maritime cabotage ("the cabotage regulation") allows Member States to impose a public service obligation (PSO) or conclude a public service contract (PSC) only if they have determined that the regular transport services would be inadequate if their provision was left to market forces alone. Moreover, the PSO or PSC must be necessary and proportionate to the aim of ensuring the adequacy of regular transport services to and from the islands (or places in analogous situation, such as long fjords or estuaries with which there are no direct road links).

Based on the information provided to us it seems that the vehicular service is sufficiently provided by the market and therefore there is no need to establish a PSO/PSC.

**Please specify the name of the case and the case number in all correspondence.**

Commission européenne, B-1049 Bruxelles / Europese Commissie, B-1049 Brussel - Belgium, Telephone: (32-2) 299 11 11.  
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The information provided by the DGFAG about the extreme build-up of traffic on the roads leading to the ports operated by the private ferry operator, Western Ferries (WF), does not seem to represent the everyday situation, but appears to relate to exceptional circumstances (e.g. a major concert, peak Christmas season). Traffic congestion on such extraordinary occasions is not uncommon, irrespective of the geographical location. Also, reportedly such exceptional traffic build-up existed even before the withdrawal of the vehicular service from the Gourock-Dunoon town centres' route. The private operator (WF) currently provides 32,000 sailings a year, with carrying capacity (in each direction) of approximately 160 cars per hour<sup>1</sup>.

As regards the DGFAG's argument that the withdrawal of the vehicular service on the Gourock-Dunoon town centres' route had negative impact on the Dunoon's economic situation, there is no reliable evidence demonstrating such a causal link. According to the MVA feasibility study the economic decline could have resulted from the current economic situation and factors such as the increase in internet shopping. Such trends can also be observed in other communities across Scotland (on both the islands and the mainland) which have not been affected by a change to their ferry service.

Finally, there is no evidential basis in the MVA study to conclude that the vehicular service is not sufficiently provided by the market. The study focused on establishing whether moving from the foot-passenger service only to a passenger and vehicle service would be feasible, i.e. generate net revenue. The fact that such a joint service could be feasible does not mean that it is necessary.

In the absence of supporting data demonstrating the insufficiency of the vehicular service currently provided by the private operator that would justify the imposition of the PSO/PSC, the inclusion of a requirement to provide both passenger and vehicle service would, in our view, not be in line with the cabotage regulation.

However, the cabotage regulation does not prohibit indicating in the tender that bidders have the option of offering a vehicle service in addition to the passenger service. In such a scenario, however, the tender should clearly state that no extra credit in the selection procedure can derive from the fact that a vehicle service is being offered since the purpose of the tender is to award compensation for the public service element only.

In the scenario of a tender designed to allow operators the option of offering a vehicle service, the tender must also include a clear and unambiguous method of cost allocation that the operator must follow should it wish to offer a vehicle service. This method should be set out in sufficient detail to be fully understood during the bidding stage. As stated in our letter of 2 September 2014, the tender should also include a clear mechanism for the claw back of overcompensation to the operator, to the extent that the vehicle service is found to be loss-making (according to the logic of this cost allocation methodology).

In your recent correspondence, you mention four options that you have explored for the allocation of common costs between future passenger and possible vehicle services.

We would observe that the "available capacity" and "incremental costs" methods seem to fix the proportion of costs allocated to the vehicle and passenger elements from the outset. Such methods do not seem to exclude to possibility of cross-subsidisation, since

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<sup>1</sup> <http://www.western-ferries.co.uk/information.shtml>

the only effective control on the operator's behaviour (and crucially on the pricing policy for the vehicle element), would be the necessity to cover the costs of the vehicle service by vehicle revenue. After those costs are covered, there would seemingly be no disincentive to the operator competing for a large proportion or all of the vehicle traffic market using a cross-subsidy from the passenger service.

By contrast, the "revenue" and "passenger numbers" methods would imply at least a minimum cost to cover with vehicle revenue for each extra vehicle transported, and thereby provide some control against a vehicle pricing policy employing a cross-subsidy from the passenger service. In effect, these two methods should set a *de facto* minimum price that the operator can charge for the carriage of vehicles.

With regard to these methods, we would tend to agree with your comment that the passenger numbers method would be simpler to monitor than the revenue method.

Overall, the passenger numbers method appears to us as the most workable alternative. However, it would appear to work best in practice if the operator were obliged to charge the same for passengers arriving on foot or by car, while at the same time allowing the operator the freedom to set the price of the transportation of the actual vehicle itself. (With this method, a higher allocation of costs per passenger, should perhaps be implemented for vehicles larger than cars).

One final point about the above mentioned "incremental costs" method, is that there is no basis in the provisions of Commission State aid decision (C 16/2008) to just allocate the incremental (i.e. extra) costs of providing a vehicle service. The decision simply refers to an, "...allocation of common costs..."<sup>2</sup>, which would seem to us to rather imply a pro-rata sharing of costs based on some appropriate method.

We are happy to provide further assistance, so please do not hesitate to get in touch again if additional details are required. Furthermore, you may wish to send us informally a draft of any tender documentation for comment, or indeed a spreadsheet example of how your chosen cost allocation might work.

Yours sincerely,



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<sup>2</sup> See in particular recital 277.



## Correspondence from DGFAG to the European Commission

1	<p><b>Subject: State aid SA.36089 - 2013/CP - Alleged subsidies granted for the Gourock-Dunoon route</b></p> <p>Dear Sir or Madam,</p> <p>Thank you for your recent correspondence by email (of 7, 16 and 22 January 2015) in response to our letter of 2 September 2014, in relation to a possible future Gourock-Dunoon ferry service. This correspondence and letter linked to various previous correspondence with regard to the State aid complaint cited in the subject above.</p> <p>You supplied information to us from the Dunoon Gourock Ferry Action Group (DGFAG) on the necessity of having a vehicle service as part of the tender for a future ferry link. You also put forward suggestions as to how costs might be allocated between a subsidised foot passenger element, and the unsubsidised commercial vehicle carrying element of the service.</p> <p>In response, may we first reiterate the various detailed points about a future service made in our letter of 2 September 2014, and add the further points below. This answer below is joint preliminary response from services of DG COMP and DG MOVE and not the formal position of the Commission. We hope it reflects a high level summary of the key points discussed in our recent teleconference of 27 January 2015.</p>
2	<p>With regard to the necessity of having a vehicle service as part of the future ferry link we would like to reiterate that EC Regulation 3577/92 on maritime cabotage ("the cabotage regulation") allows Member States to impose a public service obligation (PSO) or conclude a public service contract (PSC) only if they have determined that the regular transport services would be inadequate if their provision was left to market forces alone. Moreover, the PSO or PSC must be necessary and proportionate to the aim of ensuring the adequacy of regular transport services to and from the islands (or places in analogous situation, such as long fjords or estuaries with which there are no direct road links).</p> <p>Based on the information provided to us it seems that the vehicular service is sufficiently provided by the market and therefore there is no need to establish a PSO/PSC.</p>
2.1	<p>In its Ferry Services Plan the Scottish Government has stated that it wishes to have the return of a vehicle carrying ferry service on the Dunoon Gourock town centre ferry route [1]. A vehicle service had operated on the route from 1954 until July/2011.</p> <p>The tendering exercise that resulted in the current passenger only service demonstrated that market forces alone would not achieve the vehicle carrying service which the Scottish Government believes is in the public interest.</p> <p>The European Commission has recognised that Member States have a wide margin for discretion in defining the need of a public service and in the extent</p>

	<p>of such service – subject to there not being a “manifest error” in the assessment [2]</p> <p>It is not believed that the Scottish Government would be committing a “manifest error” if it were to seek to restore a vehicle carrying on the Dunoon Gourock town centre route by requiring that future services should carry vehicles.</p>
3	<p>The information provided by the DGFAG about the extreme build-up of traffic on the roads leading to the ports operated by the private ferry operator, Western Ferries (WF), does not seem to represent the everyday situation, but appears to relate to exceptional circumstances (e.g. a major concert, peak Christmas season). Traffic congestion on such extraordinary occasions is not uncommon, irrespective of the geographical location. Also, reportedly such exceptional traffic build-up existed even before the withdrawal of the vehicular service from the Gourock-Dunoon town centres’ route.</p>
3.1	<p>Prior to withdrawal of the vehicle service from the Dunoon-Gourock town centre route the only extreme traffic build-up was at Cowal Games, or when services were disrupted by weather. Removal of the town centre route has increased the frequency of this occurrence.</p> <p>Importantly it also impacted on the ability to deal with the extreme traffic at Cowal Games. There can be no doubt that the increased uncertainty over travel queue times for bands and judges contributed to Cowal Games losing its status as a “Major” pipe band competition. This resulted in the number of bands attending the event dropping to 24 in 2014 from the previous norm of 130-150.</p> <p>It should also be noted that the passenger only service proved unpopular with foot passengers visiting Dunoon on Cowal Games Saturday. The previous vehicle service carried 10,866 passengers in 2010, this slumped by 35.9% to 6,978 in 2011 following the introduction of a passenger only service. This decline continued in 2012 with a drop to 5,974 passengers and in 2013 with a drop to 5,721 only 52% of those carried in 2010. Loss of the “major” competition led to a further drop in 2014 to 3,743 passengers – just 34% of the 2010 numbers [3]</p> <p>As Cowal Games is the main economic event in the Cowal calendar this is extremely damaging to the local economy.</p> <p>Yes traffic congestion does occur in other locations. However in this case traffic congestion has been increased by loss of the town centre ferry service and it has had a negative impact on the ability of a fragile local economy to retain and attract large events.</p>
4	<p>The private operator (WF) currently provides 32,000 sailings a year, with carrying capacity (in each direction) of approximately 160 cars per hour<sup>1</sup>.</p>
4.1	<p>The private operator has 4 vessels each of which can carry 40 cars giving a</p>

	<p>potential capacity of 160 vehicles per hour. However it is in the interest of the operator to maximise the number of vehicles carried on each ferry crossing and its timetable makes use of at most 3 ferries.</p> <p>Prior to loss of the town centre vehicle service it was possible to arrive at either ferry service with a high degree of certainty of getting on the next sailing. That certainty no-longer exists even when exception events are not occurring. This is damaging because it undermines the viability of Cowal as a location from which people can commute by vehicle. Catching a ferry 20 minutes earlier than previously Mon-Fri for 46 weeks a year equates to 77 hours/annum an extra burden of roughly 2 working weeks spent travelling.</p>
5	<p>As regards the DGFAG’s argument that the withdrawal of the vehicular service on the Gourock-Dunoon town centres’ route had negative impact on the Dunoon’s economic situation, there is no reliable evidence demonstrating such a causal link. According to the MVA feasibility study the economic decline could have resulted from the current economic situation and factors such as the increase in internet shopping. Such trends can also be observed in other communities across Scotland (on both the islands and the mainland) which have not been affected by a change to their ferry service.</p>
5.1	<p>Removal of vehicle carrying on the town centre route had been proposed previously and legislation at the time required a Public Inquiry. This was held by the Scottish Transport Users Consultative Committee (STUCC) [7]. The Committee observed “92. Many businesses in Dunoon would suffer hardship if the car ferry services did not call at Dunoon Pier as many tourists use Dunoon Pier as a gateway to the Cowal Peninsula and businesses in Dunoon rely on passing trade for their livelihood”. The committee recommended “Caledonian MacBrayne Ltd. should in no circumstances be permitted to withdraw from this route in view of the serious hardship, inconvenience, difficulty and the knock-on effect that would be caused to users of the service. This is the unanimous view of the Committee”</p> <p>Dunoon, jointly with Campbeltown , has now been ranked as Scotland’s most vulnerable town [4]. It is recognised that removal of a transport route results in a loss of traffic, with an 11% loss being a rough and probably conservative guide [5]. Dunoon will have suffered the same economic impacts as other communities across Scotland, but loss of the town centre vehicle ferry service cannot be viewed as other than an additional negative impact.</p>
6	<p>Finally, there is no evidential basis in the MVA study to conclude that the vehicular service is not sufficiently provided by the market. The study focused on establishing whether moving from the foot-passenger service only to a passenger and vehicle service would be feasible, i.e. generate net revenue. The fact that such a joint service could be feasible does not mean that it is necessary.</p>
6.1	<p>The objective of the MVA study was to investigate financial viability. It does however also contain evidence of market need. The study showed that using only two vessels the service would be financially feasible and would capture the majority of vehicle traffic. The clear implication of that is that currently the</p>

	<p>majority of vehicle traffic is being disadvantaged, by being forced to take its least preferred route, to the advantage of the private operator.</p> <p>Furthermore the recently published accounts of the private operator show that the market is distorted. The private operator has returned a gross profit of 44.4% of Sales for the year ended 31/March/2014, 27.9% net. By any standards this is exceptionally high. Tellingly though the strategic report indicates a decrease in passenger numbers by 2.2% yet a turnover increase of 0.5%. This indicates that the operator was able to increase prices by 2.7% despite falling passenger number and is an indicator that advantage is starting to be taken of a monopoly position to the detriment of the wider local economy.</p> <p>One local haulage operator has chosen to no-longer use ferries to Cowal instead travelling by road. Anecdotal evidence suggests that other large commercial vehicle traffic is avoiding the remaining ferry crossing, it is not clear if this is because of queuing or costs. The private operator does not publish its rates for commercial traffic.</p>
7	Items not addressed in letter
7.1	<p>Other issues;</p> <ol style="list-style-type: none"> <li>1. The ferry routes form part of the public transport network. Restoring resilience, diversity and choice by resuming vehicle carrying on the town centre route is a legitimate objective. The landslide risk on the A83 at the “rest and be thankful” being a specific example of where there is benefit in having alternatives.</li> <li>2. The former town centre vehicle service reduced vehicular traffic through Gourock. The MVA report has concluded that most traffic would use the town centre route if it was operated without restrictions. Improving the environment by reducing the flow of vehicular traffic through Gourock is a legitimate objective.</li> <li>3. Larger ferries than those currently in use are required to provide a reliable service, yet the present ferries already have adequate passenger carrying capacity. Common sense dictates that the larger vessels should be used to obtain the benefits of carrying vehicles. The STUCC Public Inquiry had concluded “102. A roll on/off service is required for Dunoon and Cowal and it is illogical to separate the passenger service from the cars and commercial vehicles”[7]</li> <li>4. A passenger service will receive a subsidy. However, as demonstrated by the MVA report, a vehicle carrying service would return very substantially more funds in Harbour Dues at both Gourock and Dunoon. The overall cost of a Vehicle and Passenger service to the public purse would therefore be significantly less than that of a passenger only service. It is reasonable to take into consideration how to obtain the required services at the least the overall cost to the community.</li> </ol>

8	<p>In the absence of supporting data demonstrating the insufficiency of the vehicular service currently provided by the private operator that would justify the imposition of the PSO/PSC, the inclusion of a requirement to provide both passenger and vehicle service would, in our view, not be in line with the cabotage regulation.</p> <p>However, the cabotage regulation does not prohibit indicating in the tender that bidders have the option of offering a vehicle service in addition to the passenger service. In such a scenario, however, the tender should clearly state that no extra credit in the selection procedure can derive from the fact that a vehicle service is being offered since the purpose of the tender is to award compensation for the public service element only.</p>
8.1	<p><b>As noted earlier the Scottish Government’s policy is to restore a vehicle service on the route and the previous tendering exercise has demonstrated that leaving the matter to market forces alone would not accomplish this.</b></p> <p><b>It would appear to be within the discretion of the Scottish Government to mandate that vehicles should be carried on a future Dunoon-Gourock town centre ferry service.</b></p> <p><b>Taking into account the factors above the Scottish Government would not appear to be making a “manifest error” in deciding that restoring a vehicle service, that had been in place since 1954, would be in the public interest.</b></p>
9	<p>For brevity several paragraphs on cost allocation are omitted ....</p> <p>One final point about the above mentioned "incremental costs" method, is that there is no basis in the provisions of Commission State aid decision (C 16/2008) to just allocate the incremental (i.e. extra) costs of providing a vehicle service. The decision simply refers to an, "...allocation of common costs..."<sup>2</sup>, which would seem to us to rather imply a pro-rata sharing of costs based on some appropriate method.</p>
9.1	<p>Many different methods of attempting a pro-rata sharing of costs are available. However we are strongly of the opinion that all such methodologies are essentially arbitrary and do not represent in any real sense a ‘true’ apportionment of costs.</p> <p>We would suggest that were a vehicle and passenger service to be introduced the financial situation would be analogous to one where “..the undertaking that is to discharge public service obligations, in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tender capable of providing those services at the least cost to the community”.</p> <p>In that situation the Court of Justice of the European Union advised that “the level of compensation needed must be determined on the basis of an analysis of the costs that a typical undertaking, well-run and adequately provided with the relevant means, would have incurred.” [6]</p> <p>In essence that is “incremental costs”. Incremental Costs is a way of allocating</p>

<p>common costs, the Commission State aid decision (C 16/2008) did not prescribe pro-rata cost sharing or any specific method.</p> <p>Furthermore “incremental costs” arrives at a compensation figure which could deliver an actual working service and can therefore be considered realistic and true. It would after all be the actual compensation that would have to be paid for a passenger only service.</p> <p>More detail on Cost Allocation and the case for using Incremental Costs is given in a separate paper.</p>
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10	<b>References</b>
	<p>1. [1] Scottish Ferry Services: Ferries Plan (2013-2022) ISBN 978 1 908181 71 8</p> <p>2. <a href="http://www.transportscotland.gov.uk/system/files/uploaded_content/documents/tsc_basic_pages/Water/Scottish%20Ferries%20Plan%202013-2022.pdf">http://www.transportscotland.gov.uk/system/files/uploaded_content/documents/tsc_basic_pages/Water/Scottish%20Ferries%20Plan%202013-2022.pdf</a></p> <p>3.</p>
	<p>[2] 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)  <a href="http://ec.europa.eu/transport/modes/maritime/news/doc/com(2014)232_en.pdf">http://ec.europa.eu/transport/modes/maritime/news/doc/com(2014)232_en.pdf</a></p>
	<p>[3] Passenger number information obtained under Freedom of Information requests from CalMac</p>
	<p>[4] The 'vulnerability index', produced by the SAC Rural Policy Centre</p>
	<p>[5] Cairns, Sally; Atkins, Stephen; Goodwin, Phil (2002). "Disappearing traffic? The story so far". Municipal Engineer 151 (1): 13–22.  <a href="http://contextsensitivesolutions.org/content/reading/disappearing-traffic/resources/disappearing-traffic/">http://contextsensitivesolutions.org/content/reading/disappearing-traffic/resources/disappearing-traffic/</a></p>
	<p>[6] DEFINING THE CONCEPT OF 'SERVICES OF GENERAL INTEREST' IN LIGHT OF THE 'CHECKS AND BALANCES' SET OUT IN THE EU TREATIES 2012, 19(4), p. 1247–1267 ISSN 2029–2058 (online) Section 5</p>
	<p>[7] Report of the Transport Users Consultative Committee for Scotland on the proposed by the Scottish Transport Group to withdraw the ferry service between Gourock and Dunoon (Transport Scotland Act 1962 amended 1968) 14<sup>th</sup> September 1981</p>