

Subsidy Advice Unit Report on a proposed subsidy to CODA (Operations) Limited in relation to City of Derry Airport

**Referred by Derry City and Strabane District
Council**

24 January 2025

Subsidy Advice Unit

Part of the Competition and Markets Authority



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1. The Referral

- 1.1 On 10 December 2024, Derry City and Strabane District Council (the Council) requested a report from the Subsidy Advice Unit (the SAU)¹ in relation to the proposed subsidy (the Subsidy) to CODA (Operations) Limited (CODA) under section 52 of the Subsidy Control Act 2022 (the Act).²
- 1.2 This report evaluates the Council's assessment of compliance (the Assessment) of the Subsidy with the requirements of Chapters 1 and 2 of Part 2 of the Act.³ It is based on the information and evidence included in the Assessment.
- 1.3 This report is provided as non-binding advice to the Council. It does not consider whether the Subsidy should be given, or directly assess whether it complies with the subsidy control requirements.

Summary

- 1.4 The Assessment uses the four-step structure described in the Statutory Guidance for the United Kingdom Subsidy Control Regime (the [Statutory Guidance](#)) and as reflected in the SAU's Guidance on the operation of the subsidy control functions of the Subsidy Advice Unit (the [SAU Guidance](#)).
- 1.5 In our view, the Council has considered in detail the compliance of the Subsidy with the subsidy control principles. In particular, the Assessment:
 - (a) clearly describes the specific policy objective and equity objective of the Subsidy which it supports with appropriate reasoning and evidence (Principle A);
 - (b) clearly explains and evidences how the Subsidy would change the beneficiary's economic behaviour and that the Subsidy brings about changes that would not have occurred absent it (Principle D); and
 - (c) has conducted a thorough and detailed analysis of each of the requirements of Section 29 of the Act in relation to Services of Public Economic Interest (SPEI).
- 1.6 However, we have identified several important areas of the Assessment where conclusions rely on historical evidence. This includes when using evidence to set out the counterfactual scenario under Principle C (see paragraphs 2.23) and when

¹ The SAU is part of the Competition and Markets Authority.

² [Referral of a proposed subsidy to CODA \(Operations\) Limited by Derry City and Strabane District Council - GOV.UK](#)

³ Chapter 1 of Part 2 of the Act requires a public authority to consider the subsidy control principles and energy and environment principles before deciding to give a subsidy. The public authority must not award the subsidy unless it is of the view that it is consistent with those principles. Chapter 2 of Part 2 of the Act prohibits the giving of certain kinds of subsidies and, in relation to certain other categories of subsidy creates a number of requirements with which public authorities must comply.

describing the potential competitive impacts of the Subsidy under Principle F (see paragraph 2.39). The Assessment should provide more up to date evidence to support these conclusions or explain why the evidence cited remains relevant to current market conditions.

- 1.7 We discuss these areas below, along with other issues, for consideration by the Council in finalising its assessment.

The referred subsidy

- 1.8 The Council proposes to award a Subsidy of up to £20.667 million to CODA (Operations) Limited (CODA), towards the cost of operating the City of Derry Airport (the Airport) between 1 April 2025 and 31 March 2029.
- 1.9 The Airport currently employs over 100 staff and operates three flights a day to London, with between two and five services a week to other cities in the UK, and limited seasonal services to select destinations in Europe. During the financial year 2023/2024 153,327 passengers used the Airport.
- 1.10 The Airport was established as an incorporated company in April 2010. It is owned by the Council, which is the sole shareholder, but managed separately by CODA, a wholly owned subsidiary of the Council.
- 1.11 The Subsidy is a shortfall payment and will cover net operating costs (after income) and necessary capital investment expenditure for the Airport. It represents a continuation of annual operating funding the Airport has received from the Council since its incorporation. The Council told us it considered the Subsidy to be a subsidy in relation to SPEI because of the benefits higher levels of connectivity provide to the public and that given the unprofitability of the Airport, the services would not be provided in absence of the Subsidy. The Assessment explains that the Subsidy will be awarded through the purchase of further shares in CODA in a manner which is acknowledged not to be a commercial investment. The Council explained that for simplicity this is treated as a grant equivalent and is subject to conditions under a grant funding agreement.
- 1.12 The Council explained that the Subsidy is a Subsidy of Particular Interest because it exceeds £10 million in value.

2. The SAU's Evaluation

2.1 This section sets out our evaluation of the Assessment, following the four-step structure used by the Council.

Step 1: Identifying the policy objective, ensuring it addresses a market failure or equity concern, and determining whether a subsidy is the right tool to use

2.2 Under Step 1, public authorities should consider compliance of a subsidy with:

- (a) Principle A: Subsidies should pursue a specific policy objective in order to remedy an identified market failure or address an equity rationale (such as local or regional disadvantage, social difficulties or distributional concerns); and
- (b) Principle E: Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other, less distortive, means.⁴

Policy objectives

2.3 The Assessment explains that the policy objective of the Subsidy is to address 'an equity rationale of seeking to counter Derry and Strabane's regional disadvantage against other parts of Northern Ireland and the UK, in particular its geographic remoteness and distance from alternative air transport infrastructure allied to its low levels of income and investment per capita' by ensuring that the Airport 'may continue to function as a working airport to attract and retain reasonable levels of incoming and outgoing flights.'

2.4 The Assessment sets out that, more specifically, in giving the Subsidy the Council aims to:

- (a) 'continue to connect the people and businesses of the wider Derry and Strabane region to the outer world and economy by means of a working airport that is open to commercial short-haul airlines'; and
- (b) 'avoid what would otherwise be a significant blow to the prosperity of what is a recognised disadvantaged area in terms of the anticipated loss of jobs (including the visitor economy) and extra inconvenience of having to travel significantly further for airport access (ie to Belfast or further still to airports in Ireland).'

⁴ See [Statutory Guidance](#), paragraphs 3.32-3.56 and the [SAU Guidance](#), paragraphs 4.7-4.11 for further detail.

- 2.5 The Assessment explains that the policy objective takes account of the Northern Ireland Department for Economy's economic vision and strategic objectives of good jobs, regional balance and raising productivity.
- 2.6 In our view, the Assessment clearly describes a specific policy objective which is linked to the equity rationale, and which it supports with appropriate reasoning and evidence.

Equity Objective

- 2.7 Equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.⁵
- 2.8 The Assessment explains that declines in the textile industry and manufacturing in the early to mid-20th century led to economic decline in Derry/Londonderry and the wider area, and that high levels of unemployment, poor health and low-income levels persist relative to other UK cities.
- 2.9 The Assessment sets out that across the 11 Northern Ireland District Councils, Derry City and Strabane District Council:
- (a) ranks highest in terms of the proportion of the population living in households whose equivalised income is below 60 per cent of the NI median and first in terms of the proportion of the working age population who are employment deprived;
 - (b) ranks highest in terms of the proportion of unemployment benefit claimants within both working age males and females;
 - (c) ranks lowest in terms of gross disposable household income; and
 - (d) ranks highest in terms of the percentage of population who are economically inactive for any reason other than being a student (aged 16 to 64).
- 2.10 The Assessment sets out that the Airport is a significant economic driver for the City Region, providing critical connectivity for residents and businesses and that, according to an independent economic assessment, the baseline total direct, indirect and catalytic impact of the Airport in 2019 amounted to an additional £26 million in gross value added per annum and 850 jobs.
- 2.11 The Assessment outlines that delivery of the policy objective is intended to address the regional disadvantage faced in the area of the Council, in particular its

⁵ [Statutory Guidance](#), paragraphs 3.49-3.53.

geographic remoteness and distance from alternative air transport infrastructure, by ensuring that the region remains connected to international air transport.

- 2.12 The Assessment explains that the Council expects that without the continued operation of the Airport, the economic and social conditions in the area would deteriorate, and it expects that the Subsidy will ensure that the current economic benefits of the Airport are maintained.
- 2.13 In our view, the Assessment clearly describes and evidences the equity objective that the Subsidy seeks to address, and the Assessment makes clear that the Airport contributes to supporting the local economy and reducing disadvantage due to remoteness of the area and its distance from alternative airport infrastructure.

Appropriateness

- 2.14 Public authorities must determine whether a subsidy is the most appropriate instrument for achieving the policy objective. As part of this, they should consider other ways of addressing the market failure or equity issue.⁶
- 2.15 The Assessment explains that the Council considered several non-subsidy means of achieving the policy objective and discusses why they were not appropriate. It reasons that the Airport is the only way to achieve the desired level of connectivity, explaining how ferry services are not a realistic and competitive alternative to air transport for Derry/Londonderry. The Assessment also explains that given the financial challenges associated with operating the Airport, selling the Airport to a private operator would not be feasible.
- 2.16 The Assessment further articulates that addressing financial shortfalls through loans or guarantees would not be viable options as the Airport is unlikely to be profitable. The potential for regulatory approaches is also discussed and rejected. Finally, the Assessment outlines how the Council considered different models to improve the Airport (such as investment in a maintenance, repair and operations hangar facility) but concluded that the Subsidy is the only reasonable means of achieving the policy objective.
- 2.17 In our view, the Assessment demonstrates that the Council has considered other ways of achieving its policy objective and clearly explains and evidences why a subsidy is the most appropriate option.

⁶ [Statutory Guidance](#), paragraphs 3.54-3.56.

Step 2: Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change

- 2.18 Under Step 2, public authorities should consider compliance of a subsidy with:
- (a) Principle C: Subsidies should be designed to bring about a change of economic behaviour of the beneficiary. That change should be something that would not happen without the subsidy and be conducive to achieving its specific policy objective; and
 - (b) Principle D: Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.⁷

Counterfactual

- 2.19 In assessing the counterfactual, public authorities should consider what would likely happen in the future – over both the long and short term – if no subsidy were awarded (the ‘do nothing’ or ‘no subsidy’ scenario).⁸
- 2.20 The Assessment sets out a counterfactual scenario where, absent the Subsidy, the Airport will need to close and therefore the policy objective outlined in Step 1 would not be achieved. It explains that this is due to there being no interest in delivering the contract from the market, due to the uneconomic nature of providing the services.
- 2.21 The Assessment states that a formal tender process for private investment was undertaken in 2009, but no bids were received for outright or partial acquisition due to the ongoing need for subsidy. It sets out that the preferred outcome from this tender was a private company operating the Airport via a 10-year management contract on behalf of the Council. The Assessment explains this management contract ended in March 2020 without a purchase option being exercised by the private company.
- 2.22 The Assessment explains that without the Subsidy, rather than making profits, it would cost CODA significant funds to operate the Airport. It notes that nearly all regional airports in Europe benefit from government support designed to address disparities, citing European Commission guidelines on State aid to airlines and airports, which states that airports with fewer than one million passengers are often financially unsustainable due to disproportionate aviation safety and security-related standards.⁹

⁷ See [Statutory Guidance](#), paragraphs 3.57-3.71 and the [SAU Guidance](#), paragraphs 4.12-4.14 for further detail.

⁸ [Statutory Guidance](#), paragraphs 3.60-3.62.

⁹ [Communication from the Commission: Guidelines on State aid to airlines and airports \(OJ C99/3 2014\)](#).

2.23 The Assessment provides a consideration of the counterfactual scenario, relying on market testing from 2009 to conclude that there is no appetite from the private market to invest in the Airport. However, in our view, the Assessment should provide more up to date evidence to support its conclusion or explain why the market testing from 2009 is still relevant.

Changes in economic behaviour of the beneficiary and additionality

2.24 Subsidies must bring about something that would not have occurred without the subsidy.¹⁰ They should not be used to finance a project or activity that the beneficiary would have undertaken in a similar form, manner, and timeframe without the subsidy ('additionality').¹¹

2.25 The Assessment explains that absent the Subsidy no operator will take on the operations of the Airport as it is expected to be loss making and as such the policy objective outlined in Step 1 would not be achieved. It provides evidence from the 2009 market testing (see paragraph 2.21) to support this conclusion.

2.26 In addition, the Assessment states that the Subsidy is a shortfall payment, covering only net operating costs (after income) and necessary capital investment expenditure (see paragraph 1.11). It explains that the Subsidy will fund costs which the beneficiary would not otherwise incur, absent them entering into the contract and therefore that these costs are additional.

2.27 Finally, the Assessment sets out that there is no pre-existing commitment to provide the services funded by the Subsidy and there is no reason to believe the activities would be undertaken to the same extent, either by the beneficiary or another operator, absent the Subsidy.

2.28 In our view, the Assessment clearly explains and evidences how the Subsidy would change the beneficiary's economic behaviour and that the Subsidy brings about changes that would not have occurred absent the Subsidy.

Step 3: Considering the distortive impacts that the subsidy may have and keeping them as low as possible

2.29 Under Step 3, public authorities should consider compliance of a subsidy with:

- (a) Principle B: Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it; and

¹⁰ [Statutory Guidance](#), paragraph 3.64.

¹¹ [Statutory Guidance](#), paragraphs 3.63-3.67.

- (b) Principle F: Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the United Kingdom.¹²

Proportionality

- 2.30 The Assessment explains that the Subsidy amount is based on extensive modelling of income and costs across a range of potential scenarios, with the maximum subsidy being under a pessimistic scenario. It further explains that under all scenarios, the Subsidy will never exceed 75%¹³ of eligible costs. The Assessment states the Subsidy is the minimum amount needed to ensure continued delivery of the services and therefore running of the Airport to a minimum standard as set out in the SPEI Agreement (including substantial regulatory requirements associated with operating an airport).
- 2.31 The Assessment details a number of subsidy design elements which contribute to ensuring proportionality of the Subsidy including: (i) a monitoring mechanism where unnecessary payments are to be proportionately repaid; (ii) annual budgets which are scrutinised and approved by the CODA board;¹⁴ (iii) quarterly payment mechanism whereby no profit can be realised by CODA; and (iv) underspends recouped on a quarterly basis. The Subsidy also does not provide for any incentive payments to airlines.¹⁵
- 2.32 In our view, the Assessment demonstrates that the Subsidy is proportionate and limited to the minimum necessary to achieve its specific policy objective, in line with the Statutory Guidance. However, it could be improved by also providing an explanation of the extent to which the Council has taken steps to test the assumptions underlying the shortfall payment analysis, including that the Airport is being run in the most efficient way, to ensure the Subsidy is limited to the minimum necessary.

Design of subsidy to minimise negative effects on competition and investment

- 2.33 The Assessment outlines a number of subsidy characteristics which limit potential distortions to competition, including: (i) monitoring conditions to ensure that the Subsidy amount is minimised; (ii) limiting the Subsidy to maintaining the continued delivery of the airport services (in order to meet the public policy objective) but no

¹² See [Statutory Guidance](#) paragraphs 3.72-3.108 and the [SAU Guidance](#), paragraphs 4.15-4.19 for further detail.

¹³ The Assessment notes that the European Commission's 2014 Guidelines on State aid for airlines and airports sets out this figure below which subsidy to airports with less than 1 million passengers annually should be acceptable.

¹⁴ The Board is comprised of CODA's Managing Director, three Council officers (including the Chief Executive, Lead Finance Officer and Lead Assurance Officer), three democratically appointed Council Elected Members and four non-executive directors (covering a broad range of private sector fields of expertise including aviation, hospitality and Information Technology and representation from the Local Chamber of Commerce).

¹⁵ The Assessment states that each airline pays a market-negotiated commercial rate for use of the Airport facilities and services in consideration of the initial prospects and challenges for establishing and proving the route and long-term viability forecasts.

more; (iii) that there is previous and ongoing subsidy support already in place to the Airport; (iv) that no profit can be realised by CODA from the Subsidy; and (v) that no incentive payments to airlines are payable from the Subsidy.

- 2.34 In our view, the Assessment demonstrates how the design features of the Subsidy contribute to minimising potential negative effects on competition within the United Kingdom. However, the Assessment could have explicitly considered whether the Subsidy could impact investment decisions in other airports in Northern Ireland, and if so, if there are appropriate mitigations in the subsidy design.

Assessment of effects on competition or investment

- 2.35 The Assessment identifies the relevant market to be other airports located within 35-miles of the Airport for scheduled domestic traffic, with this radius extending further across Northern Ireland and all border regions for seasonal offerings. This is based on a combination of (i) analysis conducted by an external company in January 2022; (ii) the 2014 EU State Aid guidelines¹⁶; as well as (iii) considering evidence from previous EU cases in 2006 and 2009.¹⁷ It also considers a wider radius is appropriate when considering particular airline routes, such as to London Heathrow. The Assessment mentions a number of potential competitors, including both smaller but geographically close competitors, and larger yet further away airports.
- 2.36 The Assessment explains that the Airport has a small share of the passenger market as a percentage of Northern Ireland airports, and in recent years has faced declining passenger numbers, where some larger competitors have experienced growth.
- 2.37 The Assessment states that if a subsidy was not granted, the Airport would likely close. This could potentially benefit competitors if passengers chose to use a different airport to travel. However, the Assessment states that the impact is expected to be limited as many customers may choose not to travel to another airport due to the extra time and costs involved (noting that all alternatives are at least an hour's drive away). The impact on competitors is also expected to be limited and immaterial in the long run as the number of passengers using the Airport is very low in the overall balance of the air transport market on the island of Ireland.
- 2.38 The Assessment states there could also be some increased use of services such as buses and hire cars to access alternative airports if the Subsidy were not granted and the Airport closed.

¹⁶ The Assessment notes that the 2014 EU State Aid guidelines on aid for airports and airlines states that the relevant market would be within a 60-minute drive.

¹⁷ Case State aid No NN 21/2006 and State aid NN 65/2009.

2.39 In our view, the Assessment considers and evidences the effect of the Subsidy on competition, in line with Annex 3 of the Statutory Guidance. However, it could be improved by explicitly considering potential impacts on all close competitors where this could impact UK competition. The Assessment should also explain why historical evidence relied upon to support its conclusions is still relevant given changes in the sector over time and further consider the effect of the Subsidy on investment.

Step 4: Carrying out the balancing exercise

2.40 Public authorities should establish that the benefits of the subsidy (in relation to the specific policy objective) outweigh its negative effects, in particular negative effects on competition or investment within the United Kingdom and on international trade or investment.

2.41 The Assessment lists the expected benefits of achieving the policy objective which relate to attracting new investment and visitors to the region, development of the region and maintaining its connections with Europe, easing financial burdens faced by local ratepayers, economic and social benefits (including 850 jobs generated through direct and indirect employment), and alignment with other strategic objectives and plans of the Council.

2.42 The Assessment then considers potential negative effects of the Subsidy. It explains that the cost to the Council is outweighed by the positive annual economic impact. It also explains that, although the Subsidy may limit potential additional custom for alternative airports, the impacts on competition are expected to be minimal (see paragraphs 2.35 to 2.37).

2.43 While not explicitly included in the balancing exercise, the Assessment also considers the effect of the Subsidy on international trade and investment in Step 3 by taking into account the possible effects on airports in the Republic of Ireland, including Dublin and two smaller regional airports. It concludes that the impact on these airports is likely to be minimal.

2.44 The Assessment then assigns a score to each positive and negative effect in order to determine whether the possible positive effects of achieving the policy objective outweigh the potential negative effects of the Subsidy. It concludes that the Subsidy has an 'overall very positive score'.

2.45 In our view, the Assessment clearly sets out the positive effects of the Subsidy in relation to the policy objectives, as well as potential negative impacts, and conducts a balancing exercise between them in line with the Statutory Guidance. In particular, the assignment of scores to demonstrate the balancing exercise strengthens the Assessment, although it would benefit from further explaining the factors that determined how each score was assigned.

Other Requirements of the Act

- 2.46 Section 28 of the Act prohibits subsidies for air carriers for the operation of routes subject to certain exceptions. As noted at paragraph 2.31, the Assessment states that the Subsidy does not provide for any incentive payments to airlines.
- 2.47 The Council has also identified that the Subsidy would engage section 29 of the Act because it involves delivery of a SPEI. Section 29 of the Act includes the following requirements:
- (a) the Subsidy is limited to what is necessary to deliver the SPEI services having regard to costs of delivery and reasonable profits (s29(2));
 - (b) the Subsidy is given in a transparent manner (s29(3)), meaning that the subsidy is given in accordance with a written contract (or other legally enforceable arrangement in writing), which sets out the terms of the subsidy and contains certain prescribed information (s 29(4) and (5)); and
 - (c) arrangements are in place to regularly review the Subsidy to ensure it remains limited to the minimum amount necessary and that any excess funds can be recovered (s29(6) and (7)).
- 2.48 The Assessment states that the Subsidy will be limited to the amount necessary for CODA to deliver its services. It explains that the Subsidy will be made based on the terms of a draft agreement with CODA (the 'SPEI Agreement'), which are designed to ensure that the Subsidy is the minimum required. The amount of the Subsidy is based on projected requirements, and, in the event of a profit, the contractual terms provide for a clawback provision. This will ensure that CODA is only reimbursed for the actual operational costs of the Airport.
- 2.49 In relation to the transparency requirements, the Assessment states that the Subsidy will be given in a transparent manner according to the terms set out in the SPEI Agreement. The Council is also satisfied that the Agreement contains all the information required by the Act.
- 2.50 The Assessment states that the SPEI Agreement contains provisions which enable the Council to review the use of the Subsidy to ensure compliance with the terms of the Agreement and the requirements of the Act, including clawback provisions in the event of excess profits. Annual reviews will also be carried out to check actual performance.
- 2.51 In our view, the Assessment clearly considers the application of each of the section 29 requirements which it supports with significant reasoning and evidence. However, the Council could better explain the extent to which it has taken steps to test the assumptions underlying the shortfall payment analysis (see also

paragraph 2.32), as this would also help further demonstrate compliance with Section 29(2).

- 2.52 The Council has confirmed that no other requirements or prohibitions set out in Chapter 2 of Part 2 of the Act apply to the Subsidy.

24 January 2025