

EU Competition Briefing

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The EU Air Transport Sector in Dire Straits Are subsidies the answer and what are the conditions for receiving them?

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1. Introduction

The economic crisis has had a serious impact on the EU's air transport sector.¹ By the end of 2008, the consequences of the crisis for the sector slowly became clear: a strong decrease of freight and passenger transport demand and lower airline profits. The figures for 2009 look equally bleak. Recent statistics published by the German Federal Statistical Office show that the passenger figures (arriving at or departing from German airports) went further down by -4.5% compare to 2008.² This is the worst decline since the September 11 terrorist attacks, which resulted in a decrease of -3.2% in 2002.

In this economic climate it is predicted that more EU airlines will run into liquidity problems and might even face bankruptcy.³ Bankruptcies used to be rare in the air transport sector during the era of the so-called flag-carriers. However, bankruptcies have become more common and have had a significant impact on the market function and competition. It would appear that the trend will persist in the future, resulting in consolidation into a limited number of larger network carriers, as well as a limited number of larger low-cost carriers.

To avoid bankruptcies, EU airlines might turn to their Member States, with the view of obtaining subsidies in the form of, for example, rescue and restructuring aid. However, such aid does not come for free. Given its distorting effects on competition, any sort of subsidization needs to be approved⁴ by the European Commission ('the Commission') under a strict set of rules. This EU Competition Briefing will explain under which conditions rescue and restructuring aid may be granted to EU airlines, and it will make reference to some recent case-law.

¹ See, for example, the provisional note on 'The Impact of the Economic Crisis on the EU Air Transport Sector' (October 2009), published by the Policy Department Structural and Cohesion Policies of the European Parliament ('the EP Note'). Available at: <http://www.europarl.europa.eu/document/activities/cont/200911/20091111ATT64267/20091111ATT64267EN.pdf>

² See information of 17 February 2010 from the German Federal Statistical Office, available at: http://www.destatis.de/jetspeed/portal/cms/Sites/destatis/Internet/EN/press/pr/2010/02/PE10_054_464.templateId=renderPrint.psm

³ The EP Note, page 25.

⁴ Unless the State aid is block-exempted or below the *de minimis* threshold.

2. State aid

The concept of State aid, which is laid down in Article 107(1) of the Treaty on the Functioning of the European Union ('TFEU'⁵), applies to any economic advantage granted directly or indirectly, financed from State resources or granted by the State itself or by any intermediary body acting by virtue of powers conferred on it by the State. Article 107(1) TFEU generally prohibits State aid, unless it can be approved under Article 107(2) or (3) TFEU.

3. Rescue and Restructuring Guidelines

State aid to individual companies in difficulties is assessed under Article 107(3)(c) TFEU⁶ and the Community Guidelines on State aid for rescuing and restructuring companies in difficulty ('the R&R Guidelines').⁷ The R&R Guidelines clarify that they apply to companies in all sectors,⁸ without prejudice to any specific rules relating to companies in difficulties in the sector concerned.⁹ In this context, the R&R Guidelines refer to specific rules for the aviation sector.¹⁰ Already in December 1994, the Commission adopted Guidelines on the application of the State aid rules to air transport (the '1994 Guidelines').¹¹ The 1994 Guidelines are still valid and their rescue and restructuring conditions, which will be explained later, apply in conjunction with the conditions in the R&R Guidelines.

Both rescue and restructuring aid require first 'a company in difficulty'.¹² A company in difficulty is a company that is unable, whether through its own resources or with the funds it is able to obtain from its owner/shareholders or creditors, to stem losses which without outside intervention by public authorities would almost certainly condemn it to go out of business in the short or medium term.¹³

5 After the entry into force of the TFEU (The Lisbon Treaty) on 1 December 2009, Article 87 EC was replaced by Article 107 TFEU.

6 Article 107(3)(c) TFEU allows for aid for the development of certain economic activities or areas where such aid does not adversely affect trading conditions to an extent contrary to the common interest

7 OJ 2004 C 244, page 2. Last year the R&R Guidelines were extended until 9 October 2012 (OJ 2009 C 156, page 3).

8 Except to those operating in the coal or steel sector.

9 The R&R Guidelines are only applicable to State aid granted by EU Member States. All State aid granted by third countries to non-Community airlines is being dealt with by the EU's trade policy.

10 See footnote 3 of the R&R Guidelines.

11 Guidelines on the Application of Articles 92 and 93 of the EC Treaty and of Article 61 of the EEA Agreement to State aids in the aviation sector, OJ 1994 C 350, page 5.

12 The R&R Guidelines provide that '*A firm belonging to or being taken over by a larger business group is not normally eligible for rescue or restructuring aid, except where it can be demonstrated that the firm's difficulties are intrinsic and are not the result of an arbitrary allocation of costs within the group, and that the difficulties are too serious to be dealt with by the group itself*' (paragraph 13 of the R&R Guidelines).

13 Paragraph 9 of the R&R Guidelines.

3.1 Rescue aid

In order to prevent an airline from going out of business, an EU Member State might be willing to support the airline with rescue aid.

Rescue aid is defined as a temporary and reversible assistance. It should make it possible to keep a company in difficulty afloat for the time needed to work out a restructuring or liquidation plan and/or for the length of time needed by the Commission or the competent national authorities to reach a decision on that plan.¹⁴

In order to be approved by the Commission, rescue aid has to meet the following conditions:¹⁵

- the company must qualify as a company in difficulty;
- the aid consists of reversible liquidity help in the form of loan guarantees or loans bearing normal commercial interest rates (and at least comparable to the reference rates adopted by the Commission);
- the aid must be restricted to the amount needed to keep the company in business;
- the aid is only for the time needed (maximum six months) to devise the recovery plan;
- the aid must be warranted on the grounds of social difficulties and have no adverse effects on the industrial situation in other Member States;
- it must be accompanied, on notification, by a commitment of the Member State to communicate to the Commission a restructuring or liquidation plan or proof that the loans has been reimbursed or guarantee terminated, not later than within six months after granting the aid; and
- the aid should be a one-off operation (the ‘one time, last time principle’).

In the past, the Commission approved, for example, rescue aid to Sabena¹⁶ and LTU.¹⁷ Another case involved a bridging loan to Alitalia which the Commission approved as rescue aid.¹⁸ More recently, the Commission has approved rescue aid to the Italian airline Alpi Eagles¹⁹ and to Austrian Airlines.²⁰

¹⁴ Paragraph 15 of the R&R Guidelines.

¹⁵ Paragraph 25 of the R&R Guidelines.

¹⁶ Commission Decision of 17 October 2001 (N 636/2001 – *Sabena*), OJ 2004 C 67, page 14.

¹⁷ Commission Decision of 20 December 2001 (N 723/2001 – *LTU*), Commission letter C (2001) 4513 fin.

¹⁸ Commission Decision of 20 July 2004 (N 279/2004 – *Alitalia*), OJ 2005 C 125, page 7.

¹⁹ Commission Decision of 12 November 2008 (N388/2008 – *Alpi Eagles S.p.A.*), OJ 2009 C 53, page 2.

²⁰ Commission Decision of 19 January 2009 (NN 72/2008 – *Austrian Airlines – Rescue aid*), decision not yet published in the OJ.

3.2 Restructuring aid

Although it might be relatively straightforward to receive the Commission's approval for rescue aid, such rescue aid must be repaid after six months. If the company needs to keep the aid beyond this period it will have to undergo restructuring. In such a scenario, the original rescue aid "transforms" into restructuring aid.

Restructuring aid is based on a feasible, coherent and far-reaching plan to restore a company's long-term viability.²¹ The Commission will approve restructuring aid if the following criteria are met:²²

- the company must qualify as a company in difficulty;
- a restructuring / recovery plan is submitted to the Commission to restore viability in a reasonable time period; compensatory measures are taken to avoid undue distortions of competition (e.g. appropriate reduction of capacity);
- the aid is limited to the minimum needed for the implementation of the restructuring measures. Beneficiaries have to make a significant own contribution, free of aid;
- the company has to implement the restructuring plan in full and observe all attached conditions;
- restructuring aid can be granted only once ('one time, last time principle');
- strict monitoring and annual reporting is required;
- for small and medium-sized companies in assisted regions: the capacity reduction / own contribution criteria can be applied with a greater degree of flexibility; and
- the Commission takes a favorable view of State aid to cover the social costs of restructuring.

Restructuring aid measures for 'national' airlines have been a constant issue before the Commission. The Commission has approved several cases of restructuring aid to airlines.²³ Some of those measures – often capital injections on the basis of restructuring plans submitted to the Commission – were approved,²⁴ others found to be compatible despite violating the 'one time, last time' principle.²⁵

²¹ Paragraph 17 of the R&R Guidelines.

²² Paragraphs 32 *et seq.* of the R&R Guidelines.

²³ Commission Decision of 24 July 1991 (C 21/91 – *Sabena*), OJ 1991 L 300, page 48; Commission Decision of 22 July 1992 (N 294/92 – *Iberia*), OJ 1992 C 236, page 1; Commission Decision of 21 December 1993 (C 34/93 – *Aer Lingus*), OJ 1994 L 54, page 30.

²⁴ Commission Decision of 18 July 2001 (C 2349/2001 – *Alitalia*), OJ 2001 L 271, page 28; Commission Decision of 22 July 1998 (C 2404/1998 – *Air France*), OJ 1999 L 63, page 66.

²⁵ Commission Decision of 31 January 1996 (*Iberia*), OJ 1996 L 104, page 25.

4. The 1994 Airlines Guidelines

The 1994 Guidelines do not intend to set or develop the applicable law and criteria in the area of air transport. Rather, they summarize the pre-existing Decision practice of the Commission and also interpret and explain the requirements of Articles 107 and 108 TFEU in the context of a liberalized air transport market. Hence, they are held to not themselves establish sectoral rules but to refer to and explain the general State aid rules in the context of air transport. The 1994 Guidelines clarify that the fact that non-Community carriers benefit from State aid cannot justify a non-application of EC State aid law to EU airlines.²⁶

Concerning rescue aid, the 1994 Guidelines follow the general rules, as set out above.

With regard to restructuring aid, the 1994 Guidelines require compliance with the following conditions:²⁷

- A comprehensive restructuring plan of limited duration which aims both at restoring the airline's health within a reasonable period and at enabling the airline to operate viably without further aid. When assessing the plan, the Commission will evaluate in particular cost reductions (for example closing down of unprofitable routes), capacity reductions, efficiency improvements and other market parameters.²⁸
- A credible 'one time, last time' assurance must be given by the Member State. Any subsequent aid will be approved only in exceptional, unforeseeable circumstances external to the airline. Hence, other than under the general restructuring aid rules.
- Eventually capacity reductions but at least no expansion, i.e., no subsidization of increases in capacity or offers to the detriment of competing EU airlines.²⁹
- No government interference in the management of the airline other than resulting from normal shareholder influence.
- Exclusive use of the State aid for purposes of the restructuring plan and an adequate ratio between need and aid amount.
- No anticompetitive use of the aid and conformity to the air transport liberalization rules.
- Transparency and control of the aid granted.³⁰

²⁶ Paragraph 11 of the 1994 Guidelines.

²⁷ Paragraph 38 of the 1994 Guidelines.

²⁸ Paragraph 38(1) and (3) of the 1994 Guidelines.

²⁹ Paragraph 38(4) of the 1994 Guidelines. Commission Decision of 21 December 1993 (*Aer Lingus*), OJ 1994 L 54, page 30.

³⁰ Paragraph 38(8) of the 1994 Guidelines. Commission Decision of 22 December 2005 (C 02/2005 – *Alitalia*), Commission letter SG (05) D/207786 of 23 December 2005.

5. Recent restructuring cases

In recent years, the Commission has approved restructuring aid often in combination with rescue aid.³¹ In the case of Olympic Airways, however, the Commission decided that the restructuring aid could not be approved.³²

Last year, the Commission approved restructuring aid to Austrian Airlines.³³ As compensatory measures, Austrian Airlines offered, *inter alia*, to reduce its overall capacity in terms of available seat kilometres (ASK) by 15% of its January 2008 level by the end of 2010. Thereafter, Austrian Airlines' capacity growth will be capped at the average of the growth rate observed for airlines belonging to the Association of European Airlines. This cap will remain in force until the end of 2015 or until Austrian Airlines reaches EBIT break-even, whichever comes first. These compensatory measures were acceptable to the Commission.

6. Conclusion

It is expected that more EU airlines will run into liquidity problems and might even face bankruptcy. EU airlines in difficulties which receive State aid in order to stay afloat, require the approval of the aid from the Commission. The Commission will only approve the State aid, if it is in compliance with the R&R Guidelines and the 1994 Guidelines.

The restructuring conditions in the 1994 Guidelines provide for greater flexibility compared to the R&R Guidelines. For example, with regard to the deviation from the 'one time, last time principle', the 1994 Guidelines allow for subsequent State aid in exceptional, unforeseeable circumstances external to the airline. Equally, the 1994 Guidelines do not require a significant own contribution of the airlines concerned, compare to the R&R Guidelines.

Given the current global financial and economic circumstances, the Commission decided to allow the approval of exceptional measures, which go beyond the tight corset of the above R&R Guidelines. This flexible approach is based on Article 107(3)(b) TFEU, which authorizes State aid in case of a serious disturbance in the economy. Under this provision the Commission has approved massive amounts of State aid to financial institutions.

The future will tell whether the Commission will equally demonstrate flexibility when it comes to the approval of State aid to the EU airline industry, when it can be demonstrated that the difficulties of the airlines originate from external factors which are attributable to the financial and economic crisis.

³¹ Commission Decision of 20 December 2001 (N 723/01 – *LTU*), Commission letter C (2001) 4513 final; upon the Commission's Decision of 23 January 2003 to open formal proceedings in Case C 3/2003 – *Air Lib*, OJ 2003 C 88, page 2, in February 2003 *Air Lib* became insolvent.

³² Commission Decision of 11 December 2002 (C 4831/2002 – *Olympic Airways*), OJ 2003 L 132, page 1.

³³ Commission Decision of 28 August 2009 on State aid C 6/2009 (ex N 663/2008) – Austrian Airlines – Restructuring Plan. This decision will shortly be available at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_C6_2009

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