

## Plane Talk Aids Recovery: EU Law on State Aids to Airlines

John Milligan, Partner, and Helen Conway, Trainee, Clyde & Co, London, UK<sup>1</sup>

### Introduction

In the financially troubled world of aviation, recent European Commission and national court decisions have highlighted the difficulties faced by airlines seeking to navigate a safe course through the EU rules on state aid. The Commission's (generally) tough policy, recently demonstrated with Ryanair<sup>2</sup> – albeit in stark contrast with its even more recent approval of a EUR 400 million loan by the Italian Government to aid to Alitalia, which has done nothing to clarify, and plenty to obscure, EU state aid policy – comes at a time when many loss-making airlines around the world are banking on state aid to stave off financial disaster. While governments may be more than willing to give financial backing to airlines to keep them in the air, advisors to airlines in the EU should be fully aware of the peril of crossing the line into illegal state aid. The risk is the potentially fatal financial penalty of an order to refund the grants (plus interest) advanced.

A cursory glance at the press or European Commission press releases, however, shows the large amounts of government aid being approved, so the possibility of seeking government aid for rescue, restructuring or other emergency situation should not be written off. Awareness of the law on EU state aid therefore enables airlines legitimately to tap into state aid and, conversely, to be alert to the opportunities to challenge illegal grants which may be giving rival carriers an unfair competitive advantage.

Advisors to non-EU airlines should also be aware of the dangers of subsidies being used to the detriment of their EU competitors as a result of a Regulation which came into force in May this year. This now makes it possible for EU airlines to challenge US or other non-EU airlines (no longer just EU airlines) who may be

damaging their business with the use of reduced fares which are funded by government subsidies.<sup>3</sup>

This article will outline (1) how to assess whether grants to airlines are legal or illegal; (2) exceptions where aid is permitted; (3) procedure – the duty to notify aid to the Commission; (4) the exposure to challenges before national courts as well as the European Commission and (5) the possibility of third country airlines being ordered to pay duties if they use government subsidies to undercut EU airlines.

### (1) How to assess whether grants are legal or illegal

As outlined in a previous issue of *International Corporate Rescue*,<sup>4</sup> under EU law there are strict rules in force on the circumstances in which state aid can be granted to public and private companies. Article 87(1) EC Treaty (which applies in national law in the same way as an Act of Parliament) prohibits aid in any form whatsoever which may distort competition by favouring certain undertakings to the detriment of others.. 'Aid' is a broad concept which covers not only a cash injection or subsidy, but other advantages such as tax exemptions including deferral of tax or other payments to state, consultancy advice, or the sale of land or property at a discount, for example – specifically in the aviation context – discounts on ground handling charges, reduced or nil rent on space on the airport complex, as well as contributions to the cost of marketing the route and the recruitment and training of local ground staff.

Whether 'aid' will be illegal will be determined, broadly speaking, according to the 'market economy investor principle' – whether or not the company would have been able to obtain the funds (or other

### Notes

- 1 The authors gratefully acknowledge the helpful input of Gareth Lewis, Partner at Clyde&Co.
- 2 Commission Decision 2004/393 of 12 February 2004 concerning advantages granted by the Walloon Region and Brussels South Charleroi Airport to the airline Ryanair in connection with its establishment at Charleroi (OJEC L1 37 30 April 2004, page 1). It should be noted that Ryanair have appealed against this decision to the European Court of Justice.
- 3 Regulation (EC) No 868/2004 concerning protection against subsidization and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community (OJEC L1 62 30 April 2004, page 1).
- 4 John Milligan, 'Government Aid to Failing Businesses: The EU State Aid Rules' (2004) 1(3) *International Corporate Rescue* 153.

advantage) on the same basis from private capital markets. This will generally be the case where the structure and future prospects for the company are such that a normal return, by way of dividend payments or capital appreciation by reference to a comparable private company, can be expected within a reasonable period. It is conceded that the investor with whose behaviour the State's conduct is to be compared will not necessarily be one who is placing his capital with a view to short-term profitability.<sup>5</sup>

The notion of 'aid' has been further expanded, with particular application to the Aviation sector, by the Commission's recent decision in Ryanair. Ryanair offers low-cost fares from British and Irish airports to smaller airports located an hour or more outside the destination city, around Europe, negotiating favourable deals with the destination airport.

Acting on a complaint from Brussels Airport the Commission investigated the deal with the Walloon Region, which controls the public sector company BSCA, which manages Charleroi airport. It concluded that BSCA had agreed to grant Ryanair (i) a 50% reduction in the normal landing charges; (ii) financial incentives for each new route opened, funding for pilot training and hotel accommodation costs; (iii) preferential rates for ground handling services of EUR 1 per passenger (compared to EUR 8–13 charged to other airlines) and (iv) an undertaking to compensate Ryanair for any losses which could be incurred if there was a change in airport taxes or airport opening hours for fifteen years. BSCA also offered Ryanair office space, an engineering store, access to a training room and the use of a hangar for aircraft maintenance at a reduced or zero rate.

The Commission found that the reduced airport taxes placed Ryanair in a more advantageous position than its competitors flying out of Charleroi, while the compensation guarantee allowed it to operate in a commercial environment which was safe from any commercial risk. Applying the market economy investor principle, the Commission concluded that no private operator in the same circumstances as BSCA would have granted Ryanair the same advantages. On this basis, the advantages constituted state aid which could distort competition and the Commission ordered that Charleroi Airport demand repayment of the aid, quantified at EUR 4 million.

Exceptions permitted by the Commission in Ryanair would be aid for joint promotion and publicity, insofar as it fosters the development and improved use of secondary airport infrastructure which is currently underused as a whole. Discounts to airlines to operate new routes would be acceptable for a limited time, provided they are offered without discrimination.

## (2) Exceptions where aid permitted

Despite the many pitfalls facing airlines amid the state aid rules of the EU, there are exceptions and legitimate avenues by which of government aid may be obtained. These include:

### (i) Lesser amounts of aid

In March 2004, the European Commission extended the 'de minimis' rules on state aid to the transport sector.<sup>6</sup> Where an airline receives state aid not exceeding EUR 100 000 over a three-year period, this aid need not be notified to or authorized by the Commission in advance. Such levels of aid are deemed too low to restrict competition or trade between Member States or threaten to distort competition – and, the more pressing reason, supervision of such aid in the enlarged EU would be a heavy drain on Commission resources. Administrators of such aid should ensure of course aid granted in the previous three years does not exceed the EUR 100 000 threshold. This threshold is admittedly low, though such aid can be used alongside other approved schemes of aid.<sup>7</sup>

### (ii) Rescue and restructuring aid

Another possibility of legitimately acquiring aid is where there is a rescue and/or restructuring package (also discussed in detail in Volume 1 Issue 3 of this journal<sup>8</sup>). The conditions for the grant of such aid are strict, however, so it should be ensured in advance that the grant of aid is legal. Commission guidance on this issue is set out not only in the 1994 Aviation Guidelines (discussed above), but also in recently updated Guidelines on State Aid of Rescuing and Restructuring Firms in Difficulty 2004,<sup>9</sup> due to enter into force on 10 October, applying to aid granted or notified from that date.

## Notes

- 5 EC Commission Communication of 1994 on application of the state aid rules in the aviation sector (the 'Aviation Guidelines') (OJEC C350, 10 December 1994, page 7, paragraphs 25–28).
- 6 Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to de minimis aid.
- 7 Commission Guidelines on 'a new framework for the assessment of lesser amounts of State Aid' are expected to be adopted in late November 2004.
- 8 See footnote 4 above.
- 9 Not yet published, though the English version has been finalized and is discussed below. They replace the existing set of Guidelines adopted in 1999.

Rescue aid is a one-off operation, designed to keep a company afloat for long enough to work out a restructuring or liquidation plan. It may only be granted in the form of loans which must be paid at the end of the rescue period which cannot exceed six months. A new simplified procedure for the approval of rescue aid of no more than EUR 10 million, with a Commission decision guaranteed within one month of notification, will be introduced from October. Restructuring aid, on the other hand, is based on a feasible plan to restore long-term viability.

A company will be ineligible for rescue and/or restructuring aid in the first three years from its creation. The new Guidelines also reinforce the 'one time, last time' principle, to exclude any repeat interventions in favour of a company for at least 10 years after the earlier grant of aid. This does not, however, bar a company which has benefited from rescue aid from subsequently being granted restructuring aid. Aid granted to Sabena in 2001 in the form of a bridging loan from the Belgian Government was therefore acceptable as rescue aid, even though it had already benefited from restructuring aid. The aid, however, could not be used for restructuring, e.g. recapitalization, which in the end was a factor which contributed to Sabena's bankruptcy, the aid instead being directed to a subsidiary, which was acceptable.

It has also been a requirement of EU law that in any restructuring, the beneficiary should finance a large – though until now unspecified – part of the cost, whether by selling assets or securing external funding at market conditions. The new Guidelines will require that large companies to contribute 50% of the cost, and 25% and 40% in the case of SMEs and medium-sized companies respectively. These proportions may be reduced in cases of extreme hardship, however. In 2002, Alitalia benefited from aid of EUR 129 million from the Italian Government by way of restructuring aid and an additional capital increase totaling EUR 1.4 million. The capital increase was approved by the European Commission<sup>10</sup> on the basis that the scheme was underwritten 'to a large extent' (38% in fact) by a group of private investors and thus complied with the private investor principle discussed above. Where the State's contribution is much greater than that of the

banks, however, one may question whether the private investor principle has in fact been met.

In July 2004, the Commission controversially approved further aid to Alitalia comprising a government guarantee of a EUR 400 million loan – the guarantee being conditional on a restructuring plan, not involving further aid, reducing the Italian government's participation in the airline to below 50%, with requirements that the loan be granted at market rates and repaid within a year. As regards the one time, last time principle, the Commission concluded this was not breached since this was rescue, as opposed to restructuring, aid which had been granted previously.

It should be noted that where rescue and restructuring aid is granted, the recipient shall ignore any conditions laid down at its peril. Olympic Airways failed to observe a series of conditions attached to a restructuring plan under which the Commission had approved aid in 1998 – including that the airline should be restored to viability in the short or medium time. This failure rendered the aid illegal so in December 2002, the European Commission ordered the Greek Government to recover the aid of EUR 194 million from the airline.<sup>11</sup> The Commission is bringing further proceedings in respect of more restructuring aid by the Greek Government to a newly constituted company, on the ground of non-repayment of the earlier aid and breach of the one time, last time principle.<sup>12</sup>

### (iii) Emergency aid

Finally, specific emergency aid packages to provide compensation for damage caused by natural calamities or other extraordinary events may also be authorized by the Commission, provided there is no distortion of competition.<sup>13</sup> Such packages tend to be restricted in scope. This was the case with the measures allowed by the Commission after September 11 2001<sup>14</sup>. Here, it authorized EU Governments to compensate airlines and their service providers for the four-day shutdown of US air traffic after 11 September 2001 and to assist airlines to pay for insurance, following the decision of commercial insurers to reduce third-party liability cover for loss caused by war or terrorism. While the assistance was initially

## Notes

10 Decision 2001/723/EC, OJEC L271 12 October 2001, page 28.

11 Commission Press Release IP/03/597.

12 Commission Notice – Olympic Airways – Restructuring and Privatization (OJEC C192 28 July 2004, page 2).

13 Article 87(2)(b) EC Treaty.

14 Communication from the Commission on the repercussions of the terrorist attacks in the US on the air transport industry (COM (2001) 574 final).

stated to be limited to one month, extensions were, however, granted, the Commission stipulating that compensation systems approved should not unduly favour airlines by reference to their position before the atrocities.<sup>15</sup>

### (3) Duty to notify aid

Where a member state is proposing to grant aid, it is generally under a duty to notify the European Commission of its proposal to grant aid and seek advance clearance that the aid does not breach the EU state aid rules.<sup>16</sup> From receipt of notification, the Commission has two months (one month in some cases from October 2004) in which to issue a decision either approving the aid or stating that a formal investigation will be carried out as to whether the aid being granted is 'compatible with the Common Market' within the meaning of Article 87 EC Treaty. This further investigation can take up to 18 months, or longer if agreed with the member state. Where aid is not notified and is later found to be illegal – and this can come about with or without the intervention of the European Commission – the member state may be ordered to take all necessary steps to recover the aid repaid, with interest. If the recipient is unable to repay the funds, the member state is obliged to institute winding-up proceedings and pursue the recipient as an unsecured creditor.

There are exceptions to this requirement to seek approval in advance such as *de minimis* aid (discussed above) and aid to SMEs and training aid.

### (4) Challenges to aid in national courts

Only the Commission, subject to review by the European Court of Justice, can adjudicate on the 'compatibility of aid with the Common Market'. Aggrieved competitors may, however, sue in the national courts to challenge an aid which either has not been notified or has been paid before securing Commission approval. In such a case, the national court has the power to declare the aid illegal and invalidate the State measure giving effect to the aid, for lack of notification to the Commission as required by Article 88(3) EC Treaty, and order its recovery. While the European Court of Justice has stated that unnotified aid is not automatically 'incompatible with the Com-

mon Market',<sup>17</sup> that does not prevent national courts overturning unnotified aid. Whether the aid is subsequently notified to the Commission and validated retrospectively if it is indeed compatible with the Common Market, is a separate matter.

An example of a case being brought by a private entity in the national courts without recourse to the Commission was the challenge by the Air France subsidiary, Brit Air, before the Strasbourg Administrative Court, in respect of an agreement between Ryanair and the Strasbourg Chamber of Commerce. It was agreed that Ryanair would open services between London and Strasbourg – a route served by Brit Air – and promote the region, in return for which the Chamber of Commerce would pay over EUR 500 000 a year for five years. There was no notification of the 'aid'. Within five months, Brit Air discontinued the route due to falling profits and had by that time brought an action before the Strasbourg Administrative Court. The Court found (and was upheld on appeal by the French Court of Appeal (Conseil d'Etat)) that the grant was indeed aid, on the basis that the Chamber of Commerce had not acted as a private investor operating in a market economy, and ordered the Chamber to cancel the contracts within two months under a daily penalty of EUR 1000.<sup>18</sup>

### (5) Third country airlines

While the rules applying to EU airlines are strict, the rules applicable to non-EU airlines – shown by government grants to Swissair, for example – will often be much more permissive. An EU Regulation adopted in March 2004 addresses the concern that while European airlines are subject to strict state aid rules, they may be prejudiced by having to compete on routes to, via or from the EU with third country airlines subsidized by state aid which enables them to undercut the EU carriers.<sup>19</sup>

While certain aid was authorized by the EU following the attacks of 11 September 2001, this has been limited by the EU state aid rules. The new Regulation therefore was aimed primarily at US carriers who have benefited from government subsidies – to compensate them for the decline in air travel and curtailment or withdrawal of liability insurance which followed – but may be using them to undercut EU airlines on trans-Atlantic routes. It does not, however, replace air

#### Notes

15 Commission press release of 23 October 2001; State Aid N-123/2002 – UK Extension of Guarantee Scheme for the Aviation Industry 1/1/2002–31/10/2002.

16 Article 88(3) EC Treaty. New streamlined notification procedures are set out in Regulation 794/2004 (OJEC L140, 30 April 2004, page 1).

17 *France v Commission (Boussac)*, [1990] ECR I-307 Case C-301/87; *FNCEPA v France* [1991] ECR I-5505 paragraph 12; See also the Commission Notice on co-operation between national courts and the Commission in the field of state aids (OJEC C 312, 1995, page 7).

18 Recent Decisions of the French Conseil d'Etat, [2004] P.L. Summer, Sweet and Maxwell.

19 Regulation (EC) No 868/2004 of the European Parliament and of the Council of 21 April 2004.

services agreements with third countries that can be used to deal effectively with practices covered by the Regulation. Where a legal instrument exists at Member State level to deal with an unfair and discriminatory practice, that instrument should, therefore, take precedence over the Regulation, so before contemplating any action this is an issue airlines should check.

An unfair pricing practice is deemed to exist where carriers benefit from a non-commercial advantage, and charge air fares which are sufficiently below those offered by competing Community air carriers to cause injury, with guidance given as to the factors relevant for determining whether the subsidized air services have caused, or are threatening to cause, injury.

Non-EU airlines can be subject to an investigation into the discriminatory pricing practice which can be initiated either following a written complaint to the Commission by any 'natural or legal person or any association' or by the Commission on its own initiative if there is sufficient evidence of subsidies or unfair pricing practices, injury, and of course a causal link between the allegedly subsidized or unfairly priced air services and the alleged injury. The investigation must be carried out 'expeditiously' and normally be concluded within nine months of the initiation of proceedings. If the Commission concludes that pricing is unfair, it can impose charges on the subsidized airlines equivalent to the damage suffered by European carriers. The 'redressive measures' imposed by the European Commission on the carrier guilty of the discriminatory practice cannot, however, exceed the non-commercial advantage granted to the non-Com-

munity air carrier and can remain in force only as long as it is necessary to offset the subsidies or unfair pricing practices which are causing injury.

It remains to be seen how frequently – and with what success – this newly adopted Regulation will be invoked.

## Conclusion

If an airline or air services provider is in need of rescue or restructuring, there may be a possibility of securing aid at regional or central government level. There are rules which may facilitate this, but it should be ensured that such aid is likely to comply with EU law and that procedural hurdles, if there are any, are overcome. The sanction for breach of the rules whether at national court or Commission level – an order to repay aid (plus interest) – are potentially fatal to the airline's existence and could involve the government which granted the aid in proceedings to recover aid subsequently deemed to be illegal. The definition of 'aid' is now so broad that any preferential treatment of an airline could be deemed to constitute illegal state aid.

Non-EU airlines are no longer exempt from these rules, insofar as subsidies they receive are used to undercut competing EU airlines. It remains to be seen how these mechanisms, in force since May 2004, will work in practice, though they are a factor which non-EU airlines benefiting from subsidies should bear in mind when pricing on routes to or from the EU.