Re: HT 2635 – European Low Fares Airline Association (ELFAA) response to consultation on draft Guidelines on State aid to airports and airlines

Dear Sirs,

Introduction

ELFAA has represented Europe’s low fares airline sector since early 2004. ELFAA’s airline members carried over 200 million passengers in 2012, accounting for over 43% of intra-European scheduled point-to-point air travel.\(^1\) ELFAA’s member airlines employ some 31,000 people and offer over 4,700 flights every day throughout the EU.

ELFAA is pleased that the Commission has put forward a revised set of Guidelines, that more accurately reflects the realities of the sector than the outdated 2005 Guidelines. ELFAA has consistently pointed out to the Commission the errors of the 2005 Guidelines since their adoption, specifically through the commissioning of the Morgan Lewis opinion of April 2009,\(^2\) our June 2011 response to the previous Commission consultation on the 2005 Guidelines, and the Compass Lexecon MEIP analysis of May 2012.

ELFAA’s members have been at the forefront of the revolution in air travel in Europe, resulting from the EU’s liberalisation of market access. Over the past two decades, passengers have enjoyed low fares, greater connectivity and improved service through competition introduced by our members. Incumbent flag carrier airlines, previously operating on a monopoly or cartel-like duopoly basis and extracting punitive rents from passengers, have been challenged by the new business models of our members, and have sought to use EU State aid rules to protect themselves against competition from more efficient, innovative and customer-focused ELFAA airlines.

While the 2005 Guidelines were unrealistic and served the anti-competitive interests of the ex-flag carriers, the new draft Guidelines are a step in the right direction in terms of recognising the realities of the relationships between airports and airlines in the modern liberalised market.

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2. Setting out the implications of the Court of First Instance’s judgment in the Charleroi case on the 2005 Guidelines and pending State aid cases involving airlines.
The introductory section to the Guidelines recognises the vital role that air transport plays in the integration and competitiveness of Europe, and appears to link this role to the growth of low-cost carriers. The link is entirely correct, and the continued competitiveness and connectivity of the EU is predicated on the continued growth of airlines such as our members. Low fares airlines have revived previously under-developed regions and airports, delivering commerce and jobs to these areas, and, with the eastward growth of the EU, these kinds of opportunities continue to present themselves. Our members require realistic, market-responsive Guidelines to continue to deliver growth to these peripheral regions.

We note with some concern the arguments of the Commission that there is substantial overcapacity of airport infrastructure, relative to passenger demands and airline needs. Our members' high load factors are testament to the strength of passenger demand, and their responsiveness to low fares. Our members also envisage stimulating further demand through low fares and good service in the future. Therefore, we do not subscribe to the argument that there is substantial overcapacity of airports in the EU.

Also, the view of DG MOVE has been that there is a “capacity crunch” at EU airports, an opinion that runs counter to DG COMP's position that there is significant over-capacity. The Guidelines need to recognise that the diversion of traffic to secondary airports can, with sufficient transport links, lead to alleviation of congestion from hub airports. A dual-pronged approach of sensible investment in these secondary airports and permitting them to do competitive growth deals with airlines can achieve this policy goal. Consistent with this, DG MOVE has advocated a regional approach to easing congestion at certain affected airports by encouraging the use of latent capacity at viable alternative airports.

The Market Economy Operator Principle (MEOP)

A sensible application of the MEOP is vital to the new Guidelines working in practice and, in this respect, we generally welcome sections 3.4 and 3.5 of the draft Guidelines, with some reservations.

We particularly welcome the recognition of the principle of incremental profitability when applying the MEOP, as it is clearly the most economically sensible and realistic method, when applying the profitability analysis under the MEOP. If efforts are made during the current consultation period to change this approach, DG COMP ought to be steadfast in its defence of the incremental profitability approach, given the weight of economic theory in support of it.

ELFAA recognises the difficulty for the Commission in applying the comparator test alongside the profitability test, when applying the MEOP to arrangements between public airports and airlines. However, we would caution against a view that it is not possible in principle to find a valid market price, against which to benchmark the charges being applied by public airports, for the purposes of the comparator test. The Commission should make an effort to find valid comparators in every case, and ought to be able to demonstrate reasons why no valid comparator exists in each individual case. The comparator test is a judicially recognised part of the MEOP and should not be set aside without valid justifications.

Also, the key question to ask in applying the MEOP test is whether the recipient of a measure is gaining an “advantage” from a public undertaking. The recipient cannot be gaining an advantage if it can obtain an equivalent measure from a private undertaking. The funding status of public competitors of the private undertaking, and the consequent hypothesised effect on the prices being charged by that private undertaking, are irrelevant to the question as to whether the recipient is obtaining an advantage.

In any case, under the Commission’s proposed “transitional period” for operating aid to airports, the comparator test should become easier to apply as the period goes on, given the Commission’s intention to phase out allegedly distortive operating aid to airports.
**State aid to airlines**

ELFAA is confident that proper application of the MEOP will lead to findings of no aid to the air services contracts between our member airlines and EU airports. In this respect, our comments on the criteria for compatibility of start-up aid to airlines will be brief and limited to those situations (if any) where the MEOP will not be applicable.

The conditions for start-up aid to airlines remain strict, and although the new draft Guidelines have shortened the conditions, they appear to have been made more difficult to comply with. For example, the 2005 Guidelines allowed start-up aid to airlines for routes, operating from airports with up to 5 million passengers per annum (mppa) (up to 10 mppa in exceptional circumstances) to another EU airport. The new draft Guidelines appear to have reduced this threshold to 3 mppa (with exceptions only justified in "duly substantiated exceptional cases").

Setting arbitrary thresholds proved unworkable in the 2005 Guidelines, and is unlikely to work in practice for the new Guidelines either. Start-up aid to an airline for a new route or new schedule may be necessary and proportionate to the achievement of a valid objective (e.g. regional connectivity or correcting a market failure), even where an airport at one end of the route has over 3 mppa. Airports over 3 mppa may not be able to offer incentives that comply with the MEOP and at the same time deliver medium-term profitability to airlines, operating certain routes. If these routes deliver on an EU objective of common interest, then airports over 3 mppa should be able to offer start-up aid on these routes.

The requirement for an airline in receipt of start-up aid to have a business plan, establishing the profitability of the route without public support after 24 months, is an unreasonable burden on airlines, which are then dragged into the justification of State aid, which ought to be a matter solely for the Member State concerned. Airlines will, in any case, always make every effort to make a route profitable as quickly as possible, as it is in their interest to do so.

The rigid requirement for eligible costs is also impractical and does not capture the differences between different airports, airlines and routes. At some airports, due to, for example, the high degree of risk involved, it may be necessary to maintain marketing support to promote routes for a longer period of time than 24 months. This is not to say that the route is unviable, but that it needs a longer period of support to make it viable.

**State aid to airports**

(i) **Investment aid**

ELFAA is concerned about DG COMP’s drive to avoid “duplication” of airport infrastructure, and what it might mean for regional airport policy throughout the EU. Our members recognise the need to stop large amounts of aid being poured into unviable airports in the catchment areas of existing airports, but the Commission must take a case-by-case look at each project. ELFAA has no issue with the requirement for a business plan to justify aid for new infrastructure in the catchment area of existing airport infrastructure, but we object to the need for this business plan to identify the effect of the proposed aid on high-speed rail connections. Rail is one of the most highly-subsidised industries in the EU, and the effects of investment aid on these already-subsidised connections is likely to be minimal.

Regional airports have helped to ease the “capacity crunch” at EU airports, as well as delivering jobs and connectivity to the regions, in which they are located. ELFAA would caution against an overly-prescriptive approach to compatibility of investment aid, where these goals are likely to be achieved by public support for additional infrastructure. In this respect, there may be cases where airports of a certain size require more aid than prescribed in paragraph 92 of the draft Guidelines, and the Guidelines ought to recognise exceptions to these thresholds, where an EU objective of common interest is likely to be achieved by some level of investment aid.
It should also be noted that hub airports received decades of public funding, prior to the application of the State aid rules to the construction of airport infrastructure, and the Commission should avoid an approach, that handicaps airports that did not receive aid during this period, from competing with hub airports on a level playing field.

(ii) Operating aid

It is clear that some airports in the EU are unable to meet their operating costs without some public support. The Commission envisages a 10 year transitional period, following which no operating aid will be payable to airports whatsoever. ELFAA does not think this is realistic and envisages some requirement for operating aid following this transitional period, as it is unlikely that some airports, currently in receipt of operating aid, will be able to drive efficiencies and raise charges to airlines to the extent needed to reach total operating cost coverage, and yet closure of these airports may run counter to EU objectives of regional development and connectivity.

Our member airlines are already in a constant dialogue with airports to achieve operational efficiency, in order to ultimately deliver low fares to passengers. There may be little scope for additional efficiency gains at some of the regional airports to which our members fly. In addition, our member airlines are unlikely to accept unilateral, unjustifiable, charge increases that will affect their ability to maintain low fares. ELFAA airlines require a basic level of service from the airports to which they fly, fully justifying low airport charges, and would find it difficult to commercially justify paying higher airport charges at airports, where they receive basic airport services.

Our members have also raised concerns about how the 10 year transitional period will operate in practice. The requirement for a progressive increase of a minimum average of 10% per annum in operating cost coverage is too rigid, as it fails to recognise that operating cost coverage may become easier for some airports towards the end of the transitional period, and they may not be able to achieve full operating cost coverage within the timeline set in the Guidelines. For example, an airport covering 50% of its operating costs will only have five years to reach full operating cost coverage, whereas its particular specificities (e.g. traffic mix, location, human resource issues etc) may demand a longer period to reach full cost coverage. In this respect, the need for the minimum 10% increase should be removed.

In practice, our members also envisage problems with an airport trying to renegotiate contracts with airlines in the middle of their term, seeking to increase charges, in order to assist in reaching full operating cost coverage. This may involve airports trying to renegotiate on an annual basis, depending on changes in their revenues, arising from passenger volume decreases. We envisage a “vicious circle” here, where airports attempt to renegotiate contracts, or unilaterally breach them by imposing charges increases, leading to airlines exiting the airport, leading to increased charges demands on the remaining airlines, and so on. The airport may be viable, but the Commission’s policy on the transitional period could ensure its demise.

Other elements of the requirements for compatibility of operating aid to airports are also of concern. There seems to be very little scope for adjusting the terms of the ex-ante fixed lump sum over the transitional period, and this may lead to significant funding difficulties for airports, where the sum is miscalculated at the outset (perhaps for very good reason). Ideally, the operating aid should be allowable in annual tranches (as it would be able to be calculated accurately, and still on an ex-ante basis). If, notwithstanding, the Commission insists on a fixed lump sum, there should be some mechanism for adjustment during the 10 year transitional period, if justified.

Public Funding of Services of General Economic Interest (SGEI)

ELFAA members do not have a particular view on the sections of the draft Guidelines concerning SGEI, as they merely restate existing law and practice. However, we would note that while our member airlines endeavour to operate routes that are economically viable, some airports around Europe are providing services that fall squarely into the definition of SGEI. They should not be unduly penalised, if the formalistic criteria of Altmark are not fully complied with, as compensation
EFAA looks forward to engaging positively with the Commission on the development of the Guidelines, which represent a step in the right direction as far as our members are concerned. With a proper application of the MEOP and clear Guidelines, the current uncertainty surrounding aid in the aviation sector should be removed, and industry can act with more clarity.

We hope that the Commission will consider our concerns as expressed above. Please feel free to contact me if you require any clarifications or further information.

Yours faithfully,

John Hanlon
Secretary General
European Low Fares Airline Association