IAG comments on the Draft EU Guidelines on State aid to airports and airlines

The International Airlines Group, formed in January 2011, brings together Iberia and British Airways, the leading airlines of their respective home base countries. The company is Spanish registered, listed in London and Madrid and headquartered in the UK.

This year Vueling became fully part of the IAG Group. The airline is growing rapidly, its revenues were up by more than 27% in 2012, and its business model combines a low cost base with a high service level. This year it expects to fly 16 million passengers in total. In addition to its original base at Barcelona, it has also established a strong and growing presence outside Spain in, Paris Orly and Florence.

In total IAG’s airlines now fly more than 69 million passengers annually, serving more than 220 destinations and operating 435 aircraft.

The state of the European airline industry

The airline industry in Europe continues to face a very challenging environment. Passenger numbers are growing slowly, although in 2012 some markets, including Spain and Italy, actually contracted, but profitability for much of the industry is anaemic or worse. The European market place has seen strong growth in low cost carriers. These carriers have grown markets, opened new connections and forced the whole industry to improve the value it offers customers.

For Europe’s traditional carriers the imperative is to improve the value of their customer offer by raising their productivity and cutting costs, while maintaining service quality. Their future is fundamentally in their own hands and IAG itself is taking the steps necessary to improve the performance of Iberia in particular. IAG believes the route to improving European airline profitability should not involve restricting competition or paying state subsidies to avoid restructuring. This kind of aid distorts competition.

State aids

On state aids, we believe the principal issue for the Commission should be using their existing powers and responsibilities to ensure that member state governments do not provide aids to failing “flag carriers” nor block restructuring and, where it is desirable, consolidation. On the current Commission Communication on new Guidelines for State aid to airports and airlines, we welcome the opportunity to comment. Our comments primarily deal with payments to airlines for the opening or operation of routes.
In IAG’s view the major issue for Europe on airport infrastructure is actually building additional capacity at those airports where there is clearly demand. However, we acknowledge the Commission’s concern that in recent years, in some member states, there has been the development of new airports and additional capacity for which there is unlikely to be a real need.

We are also concerned that the construction by some airport operators of uneconomic infrastructure may have a distorting impact on pricing and investment at other economic and viable facilities within their portfolio.

In this respect we are disappointed that the guidelines do not address the issue of airports integrated into networks where the owner relies on cross-subsidisation as between financially sound and unsound airports which creates competitive distortion among the users operating at different airports. Particularly worrying is the situation of non-profitable airports integrated into a national airport network. While non-integrated airports will not have other way out than increasing their charges and try to survive on their own in the long/medium term, other small airports, equally unprofitable but integrated into an airport network, will not be forced to be viable on their own. These airports will continue hiding their lack of sustainability keeping charges artificially low at the expense of other airport users operating at larger airports. As a consequence airlines operating at large profitable airports pay for infrastructure they do not use, while at the same time other airlines, operating at smaller non-profitable airports, benefit from lower airport charges that do not reflect the real cost of the airport services used as they rely on cross subsidy by the former. To avoid this situation we believe that charges should be airport specific.

IAG therefore welcomes the prospect of the introduction of a framework for more sensible investment decision-making and airport operation. We believe there should be a timely transition to new arrangements with the aim of avoiding a situation where airport costs are not actually rationalised but are simply passed on to on airlines in the form of higher charges.

IAG also believes that the framework for state aid in airport infrastructure should be matched by a framework for rail infrastructure. European competitiveness and economically rational investment requires that there should be level playing field with no distortions of competition where air and rail are competing. The industry has long argued that true intermodality is only achievable if high-speed rail is integrated into the main hub airport.

We therefore believe the principles applicable to the Market Economic Operator Principle (MEOP) in respect of the aviation sector should apply on a consistent basis to the rail sector as well, including the provision of core infrastructures and access to such infrastructures.

**Airports and airlines**

IAG believes the MEOP should be at the heart of the relationship between airports and airlines. Airports provide a range of incentives to attract airlines, just as any business does to attract customers. What matters is that it is genuinely non-discriminatory and meaningfully available to all airlines and is compatible with the airport being viable for the long-term.
Further specific comments

1. The Market Economic Operator Principle

We welcome the recognition by the Commission that MEOP principle applies to public owned airports. Due to the increasingly competitive nature of the airline and airport industry, a number of airports offer discounts and / or financial or other incentives (known as "Incentive Schemes") to entice airlines into offering new or expanding existing services. For airlines these incentives can deliver cost reductions which are then passed on to consumers in the form of lower fares.

In our experience there is a wide scope and combination possibilities of incentive schemes, as summarised in the taxonomy table below. The Guidelines are right to steer away from proscriptive rules on compliance with the MEOP in relation to these complex and heterogeneous airport/airline arrangements.

Rather, we believe that it is up to the management teams within individual airports (or groups of airports) to devise appropriate incentive schemes that encourage airline operators to deliver the objectives that the particular airport desires. For example, certain airports may wish to encourage all year round service, others may wish to encourage certain aircraft type or privilege certain routes or air links (e.g. Malta International Airport has chosen to waive all landing fees for the 2011/2 winter period (Times of Malta, 2011) while BHX targeted certain types of aircraft operations, Hannover airport has operated a "select your own discount" scheme).
This creative freedom is responsible for producing the vast array of incentive schemes that are in use today. The Commission is right to encourage this flexibility. However the existence of a business plan is considered as proof of the application of the MEOP. But there is an information asymmetry for the airline which does not have the necessary information nor the ability to influence the business plan which could potentially compromise existing or developing routes should enforceability of this provision be sought.

Therefore the lack of an adequate business plan should burden the airport, but not the airline \textit{(in dubio pro reo)}. Because they do not have access to all airport cost data, an airline must be able to operate on the assumption that airports have selected forms of incentive that are compatible with the MEOP test and state aid rules.

2. Non-aeronautical revenues

We share the Commission’s view that in setting up an arrangement with an airline the airport operator should demonstrate that the revenue stream should cover the costs and a reasonable profit on the basis of sound medium-term prospects. These revenues can account for up to a half of an airport’s revenues. However, the Guidelines should tackle the issue of airport operators introducing clauses where, for instance, the airline commits not to offer parking or other ancillary services other than those provided by the airport operator. There needs to be clarity whether such clauses infringe competition law.

3. Compatible start-up aid

- New routes and new frequencies

We believe the Commission’s proposal to restrict compatible aid to new routes does not recognise the realities of the market. Incentives offered by airports usually reward traffic volumes, traffic growth or long-term traffic commitments and, only secondarily, new routes or frequencies. Airports do not attach importance to whether growth or revenues come from a new route or an existing one. Therefore, if the MEOP does apply, the possible exemption of the State aid concerned should not automatically exclude existing routes.

- Airports with more than 3 million passengers per annum

Airports with more than 3 million passengers per annum generally support a profitable operation and therefore incentives offered by them will generally comply with the MEOP. However, an airport with such passenger traffic may be underutilised and not fulfill its development potential. In these cases, public authorities could legitimately take the view that to meet regional development and social cohesion goals aid should be offered to support growth. To permit this, in the event the MEOP cannot be satisfied, public airports with more than 3 million passengers per annum should not be precluded from offering compatible aid.
• Up to 24 months and up to 50% of the start-up costs

In our view the Commission’s proposed “one size fits all” approach fails to take into account the specifics of different airports and airlines. At some airports it may be necessary to offer marketing support for longer than at other airports as demand may be seasonal rather than year round. Moreover, public airports and public authorities should be allowed to match the behaviour of private airport operators by offer incentives at a level which will attract airlines to operate there according to market conditions prevailing at the time and is the equivalent of a private operator pricing according to demand. An alternative more realistic approach to the Commission’s current proposal would be to introduce a system in which levels of permissible support is permitted to taper off. This is in line with private airports where the amount charged by the airport to the airline gradually increases until the standard charge is realised, normally after three or four years.

• Eligible costs for compatible aid

We believe that state-aid should be compatible not just to cover “start-up costs” but also to support existing routes. As we have argued above, for the airport operator the key issue is gaining additional revenue regardless of whether it comes from new or existing routes or frequencies, from aeronautical or no-aeronautical activity. It is therefore economically sensible for the operator to offer whatever is most effective (discount on charges, support for marketing or incentives to base aircraft) to attract additional revenues.

• Ex ante business plan should show that the route will become profitable for the airline after the start-up period of 24 months.

No responsible airline should initiate route operations without reasonable expectation of long term profitability, but when launching a new route it is in practice difficult to determine the profitability prospect of the routes ex ante. The performance of routes depends on a range of factors outside of the control of the airline launching the new route. These include the macro economic situation, the cost of fuel and the arrival of new competitors on the route. Given these realities, an airline should be able to terminate, without penalty, an arrangement with an airport at any time if the route proves not to be viable due to factors outside the airline’s control.

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