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<p>In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...].</p>	<p>PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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Subject: State aid SA.37220 (2014/C) (ex 2013/NN) – Cyprus – Restructuring aid for Cyprus Airways (Public) Ltd and SA.38225 (2014/C) (ex 2014/NN) Training aid for Cyprus Airways (Public) Ltd

Sir,

The Commission wishes to inform Cyprus that, having examined the information supplied by your authorities on the measures referred to above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union.

PROCEDURE

1.1. The pending formal investigation procedure (SA.35888 – 2013/C)

- (1) On 6 March 2013, the Commission informed Cyprus that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union ('TFEU')¹ ('the decision of 6th March 2013') as regards three measures adopted by Cypriot authorities in favour of Cyprus Airways (Public) Ltd ('Cyprus Airways' or 'Company'). The measures were:
- a. A non-notified "in advance" payment by the State for the company's planned capital increase of EUR 45 million. The measure was already disbursed in 2012;
 - b. A non-notified EUR 73 million rescue aid loan by the State. The first tranche of this measures was disbursed on 22 January 2013;

¹ OJ C 152, 30.5.2013, p. 12.

- c. Envisaged granting of *ex gratia* compensation by the State to Cyprus Airways personnel, which would be considered redundant in the context of the company's restructuring.

- (2) That investigation is still pending.

1.2. The notification of restructuring plan (SA.37220 (2013/C)(ex2013/NN)

- (3) By pre-notification of 22 July 2013 the Cypriot authorities communicated to the Commission a draft restructuring plan.
- (4) On 23 October 2013 the Cypriot authorities notified an updated version of the restructuring plan which includes a series of restructuring aid measures. Additional information was requested by letter of 15 November 2013, to which the Cypriot authorities replied on 10 January 2014.

1.3. Monitoring of training aid scheme

- (5) In the context of the regular monitoring of approved or exempted schemes, the Commission services have assessed the implementation of a Cypriot training aid scheme,² which was based on the Commission Regulation (EC) No 800/2008 (General Block Exemption Regulation, 'GBER').³
- (6) The Commission asked information with letters of 3 December 2012, 15 February 2013 and 6 May 2013, to which the Cypriot authorities replied on 19 December 2012, 14 March 2013 and 30 May 2013. The submissions by the Cypriot authorities showed that Cyprus Airways had received training aid in 2010-2011, which may not have been in line with the Cypriot training aid scheme and the GBER. Thus, the Commission initiated the case SA.38225 (2014/C ex 2014/NN) Training aid for Cyprus Airways (Public) Ltd.

THE BENEFICIARY

- (7) Cyprus Airways was established in 1947 and has its principal activities in the transportation of passengers and cargo by air and other airline-related services. The company is listed on the Cypriot Stock Exchange. At the beginning of 2013, following a share capital increase, the main shareholder of the Company was the Cypriot State with a shareholding of 93.67% and private investors held the remaining shares.
- (8) Cyprus Airways operates scheduled air services to approximately 15 destinations, currently has a fleet of 6 aircraft (Airbus A320) and had approximately 600 employees at the end of 2013. It therefore qualifies as a large enterprise.⁴
- (9) In 2005 Cyprus Airways benefitted from CYP 30 million (EUR 51 million) of rescue aid and in 2007 from a number of restructuring measures consisting mainly of (i) loans of CYP 55 million (EUR 96 million) [of which a loan of CYP 45 million (EUR 78 million) was backed by a State guarantee] and (ii) a capital increase of CYP 14 million (EUR 24

² SA.27573 (2012/MX) – *Scheme for constant training programmes for individual enterprises – Cyprus*, approved in Cyprus by the Decision of the Commissioner for State Aid Control, published in the Cypriot Official Gazette nr. 8025 of 21 November 2008.

³ Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Article 87 and 88 of the Treaty.

⁴ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.05.2003, p.36.

million), which involved public and private shareholders on equal terms. These measures were authorised by the Commission as compatible restructuring State aid.⁵ on ts

- (10) Moreover, Cyprus Airways receives an annual compensation for losses incurred as a result of the ban imposed by Turkey on Cypriot aircraft flying through its air space. The compensation is based on an aid scheme authorised by the Commission pursuant to Article 107(2)(b) TFEU.⁶

THE CYPRIOT AIR TRANSPORT MARKET

- (11) Cyprus has two international airports, Larnaca (close to the capital Nicosia) and Paphos. Because of the small size of the island, most travellers from/to Cyprus can easily reach either airport.
- (12) The main origin of incoming passengers is the UK and Russia, with significantly less passengers coming from Germany, Sweden and Greece. The inflow of passengers has a high seasonal fluctuation: in the peak summer months (July-August) there are more than 3 times more passengers than in the low winter months (December-February).
- (13) Cyprus Airways has an average market share of 15% of traffic to/from the island (2012 data), but its market share fluctuates depending on the season. The most important markets for the company are routes between Cyprus and Greece and the UK. Cyprus Airways was also active in domestic flights in the Greek market until mid-2013. Certain routes to the Middle East have also been traditional markets for Cyprus Airways.
- (14) Major European air carriers have been traditionally active in these markets with regular flights. However, some routes are only serviced on a seasonal basis. More recently Cyprus Airways has been facing competition also by low cost airlines, some of which have established a basis in Cyprus.
- (15) The Cypriot economy has been facing difficulties, demonstrated by a GDP contraction since 2009, an increase of the budgetary deficit and an increase in unemployment. Due to the deterioration of its financing conditions, the Cypriot State has also requested financial support by the euro area Member States and the IMF.
- (16) As a result of the recession in Cyprus, but also in other European countries, the number of passengers travelling to and from Cyprus has decreased. The average fare price has also dropped significantly. The future performance of the Cypriot market will depend on both the recovery in Europe but also the situation of the local economy.

DESCRIPTION OF THE MEASURES

1.4. Notified measures

- (17) The restructuring aid measures amount to EUR 102.9 million.
- 1.4.1. Measure 1: EUR 31.3 million contribution by the State to the 2012 share capital increase*
- (18) During the period September 2012 until December 2012, the State disbursed EUR 31.3 million to Cyprus Airways in the form of "in advance" payments. This amount was the State's contribution to a planned share capital increase of a total of EUR 45 million. Eventually private shareholders contributed only EUR 106,000, thus the share capital of

⁵ N69/2005, Decision of 3 May 2005, published in OJ C 191, 5.8.2005, p. 4 and C 10/2006 (ex N555/05), Decision of 7 March 2007, published in OJ L 49, 22.2.2008, p.25.

⁶ SA.32523 (2011/N), Decision of 27 June 2012, published in OJ C 230, 1.8.2012, p.1.

the company was only increased by EUR 31.4 million. The shareholding of the State in Cyprus Airways was raised accordingly.

- (19) This measure was already included in the decision of 6 March 2013. At the time the Cypriot authorities claimed that the measure was an intervention that did not involve state aid, because any market economy investor would have provided such measure to maintain its company.
- (20) The Cypriot authorities also argued that part of the EUR 31.3 million was included in the rescue aid loan notification. However, the authorities subsequently clarified that the EUR 31.3 million was not related to the rescue aid notification and that the amount had already been paid in 2012.
- (21) Under the notification at hand, the authorities have maintained their argumentation that the measure does not involve state aid. However, they have included the capital increase of EUR 31.3 million as part of the notified restructuring aid.

1.4.2. Measure 2: Debt-to-equity swap of the rescue aid loan

- (22) During the period 22 January 2013 until 26 July 2013, the Cypriot State paid tranches of the rescue aid loan to Cyprus Airways, in total of EUR 34.5 million. This rescue aid was already included in the decision of 6 March 2013.
- (23) The Cypriot authorities have explained that the disbursed amount will not be repaid by the Company and the corresponding debt will be converted into equity.

1.4.3. Measure 3: Debt-to-equity swap of the 2007 State guarantee

- (24) As explained above, in 2007 and as part of the approved restructuring package, the Cypriot State had provided a guarantee for a loan of CYP 45 million (EUR 78 million), which Cyprus Airways took from Hellenic Bank. This loan had been serviced regularly through bi-annual instalments and in August 2013 the outstanding amount to be repaid was EUR 28.5 million.
- (25) Under measure 3 the Company will not repay the outstanding amount to Hellenic Bank. As a result the State guarantee will be called, which will create an additional debt of Cyprus Airways towards the State, since the latter will have to repay the loan. That debt of EUR 28.5 million will subsequently also be converted into equity by the State.

1.4.4. Measure 4: Coverage of Provident Fund debt

- (26) Cyprus Airways' Provident Fund for the Cyprus-based employees (excluding pilots) is a defined benefit scheme, paid through contributions by the employees and Cyprus Airways. The entire amount allocated to the Provident Fund based on the contractual entitlements of the personnel ("purchasing power") is ultimately at the disposal of the Company. The Provident Fund's purchasing power is also guaranteed by the Company.
- (27) As a result of poor investment performance, the Provident Fund is now facing a significant deficit, calculated on 1 January 2013 as EUR 12 million on a going concern basis (i.e. assuming that Cyprus Airways will continue to operate) or EUR 14.9 million on a discontinued basis.
- (28) The Cypriot State will cover EUR 8.6 million of the Provident Fund's deficit on a going concern basis, whereas the remaining amount will be covered through real estate transactions, described below.

1.4.5. Short term loan

- (29) The restructuring plan also envisages a possible EUR 10 million short-term loan by the State, which, according to the Cypriot authorities, will be granted on market terms. However, the envisaged granting date or conditions of this loan have not been clarified by the Cypriot authorities.

1.5. The Restructuring Plan

- (30) The restructuring plan envisages a restructuring period from April 2012 (granting of the first tranche of the share capital increase) until the end of 2017. The aim is to restore the profitability of Cyprus Airways as of the financial year 2014. However, the Cypriot authorities have clarified that the restructuring plan does not address the fundamental business model of the Company. The Company has already undertaken some of the measures envisaged under the restructuring plan.

1.5.1. Restructuring of fleet and operations

- (31) The restructuring plan envisaged a reduction of the fleet to 6 aircraft (from 13 in the beginning of April 2012). This reduction was achieved by 10 December 2013, through the sale of 2 owned aircraft in April 2012 and the expiry of lease contract for another 5 aircraft. Out of the remaining fleet of 6 aircraft, 5 aircraft, which have been leased by Cyprus Airways, will be kept in operations, whereas one aircraft, which is owned by the company, will be held as spare.
- (32) The reduction in the fleet will be reflected in a reduced number of routes to 13. The following routes have already been closed since April 2012: LCA-ATH-SKG-LCA; LCA-ATH-HER-LCA; LCA-ATH-RHO-LCA; LCA-LED.⁷ The following routes are also planned or have already been closed: LCA-HER-RHO-LCA; LCA-SKG-HER-LCA; LCA-SKG-RHO-LCA; LCA-FCO; LCA-VIE and [...]*, which will be replaced by [...].⁸ Also, the Company will reduce the frequency of 3 routes: LCA-LON, LCA-SKG and LCA-HER.⁹ The following routes are envisaged to be maintained: LCA-ATH, LCA-SKG, LCA-HER, LCA-AMS, LCA-CDG, LCA SVO, LCA-SOF, LCA-FRA, LCA-MUC, LCA-ZRH, LCA-TLV, LCA-BEY, LCA-STN.¹⁰
- (33) According to the Cypriot authorities, the restructuring plan thus envisages a capacity reduction of 35% in terms of ASK¹¹ as compared to the 2012 capacity.
- (34) The plan envisages a better allocation of flight times, in order to maximize fleet utilisation. The route to London is considered as strategic regardless of the change to Stansted airport, because of the possibilities for transit flights to overseas destinations.

1.5.2. Cost reduction measures

- (35) The restructuring plan envisages cost cutting measures of a total of EUR [42.5-52.5] million by the end of the financial year 2014 as a base scenario. The main components are staff redundancies (EUR [10-20] million); other staff cost reduction (EUR [2.5-5]

⁷ LCA: Larnaca; ATH: Athens; SKG: Thessaloniki; HER: Heraklio-Crete; RHO-Rhodes; LED: St. Petersburg.

* Information covered by the obligation of professional secrecy, according to the Commission Communication on professional secrecy in State aid decisions (OJ C 297 of 9.12.2003, p. 6).

⁸ FCO: Rome Fiumicino; VIE: Vienna, [...], [...].

⁹ LON: Collectively referred to airports in the London area.

¹⁰ AMS: Amsterdam Schiphol; CDG: Paris Charles de Gaulle; SVO: Moscow Sheremetyevo; SOF: Sofia; FRA: Frankfurt Am Main; MUC: Munich; ZRH: Zurich; TLV: Tel Aviv; BEY: Beirut.

¹¹ Available seat kilometres.

million); reduction in fuel costs (stemming from a unified fleet of Airbus A320 with reconfigured seat capacity – EUR [10-20] million); passenger savings costs (such as removal of the catering option in economy class – EUR [5-7.5] million); renegotiation of ground handling fees at LCA airport (EUR [2-4.5] million); renegotiation of airport and en route fees (EUR [1.5-4] million); ceased aircraft lease costs (EUR [2.5-5] million).

- (36) In addition to the fleet and routes reduction, the following measures have been implemented by January 2014: removal of catering in economy class, renegotiation of ground handling fees at LCA airport (but subject to payment by Cyprus Airways of an outstanding debt towards the handling company); 10% salary and Provident Fund contribution reductions.
- (37) As regards staff redundancies, the staff number has decreased from 1,037 since December 2011 to 650 in January 2014, whereas further redundancies of 321 staff members seem to have been agreed but pending. The Cypriot authorities clarified that no *ex gratia* compensation was granted for these redundancies.

1.5.3. Revenue initiatives

- (38) As regards new revenue initiatives, the restructuring plan assumes fare increases of 2-3% per year as of 2015 in the base scenario. As a low case, the restructuring plan assumes a revenue decrease of 1% in 2014 and no increase after 2015.
- (39) In addition, the plan makes reference to ancillary revenue from additional service provided to passengers, but it does not make any concrete assumption about the amount.

1.5.4. Restoration of viability - assumptions

- (40) The restructuring plan envisages the restoration of the company's viability as of 2014. The plan contemplates the following financial results in the base scenario, assuming that the financial restructuring (measures 2, 3 and 4) will be implemented before 2013:

Table 1: Envisaged profit and loss (base scenario) (in million EUR)

	2013	2014	2015	2016	2017
Revenues	168.1	108.2	109.6	111.7	113.1
EBIT	(18.8)	0.4	2.1	4.6	6.0
Net result before tax	(18.9)	0.4	2.1	4.6	6.0
EBIT %	(24.9)%	0.4%	1.9%	4.1%	5.3%
Capital reserves	0.0	0.0	0.0	0.0	0.0
Total reserves	(103.1)	(102.7)	(100.5)	(96.0)	(90.0)
Total equity	1.4	1.8	4.0	8.5	14.5

- (41) Concerning profitability, the restructuring plan contemplates the following profitability:

Table 2: Envisaged profitability

	2014	2015	2016	2017
ROE	21.2%	54.1%	53.5%	41.3%
ROCE	1.2%	6.1%	11.4%	13.0%

- (42) Apart from the above-mentioned restructuring measures, the results are based on the following assumptions:
- Reduction in passengers and revenue, as a result of the reduced network;
 - Savings in fuel costs because of increased use of fuel management system. Headline price of fuel is assumed flat;
 - Rescheduling of third-party debt – no new lending;
 - Stable USD/EUR exchange ration until 2017.
- (43) The profitability is mainly driven by the remaining flights [...], which are the only flights with [...].
- (44) The restructuring plan includes a high and low case scenario. The low case scenario reflects only the revenue decrease described in recital (38) above and assumes a EBIT of (0.3) million for 2014, 0 for 2015 and 0.3 million for 2016 and 2017.
- (45) The plan acknowledges certain risks related to the restoration of viability, without reflecting them in the low case. In particular:
- Macro-economic risk, especially related to a possible rise of the oil price or a change in the USD/EUR exchange rate. For either of the two latter examples of risk, the plan calculates separately the impact of a [0-2.5]% variation at approximately EUR [200-700] thousand for one year.
 - Risk of increased competition on the routes to Tel Aviv and Moscow.

1.5.5. Restructuring costs and funding

- (46) The total restructuring costs amount to EUR 147.4 million and will be allocated according to the following categories:

Table 3: Restructuring costs (in EUR million)

Accumulated losses	99.7
Other restructuring costs (aircraft lease settlements, redundancy entitlements etc)	10.4
Working capital	37.4
<u>Total restructuring costs</u>	<u>147.4</u>

- (47) As a result of measures 1, 2, 3 and 4, the total restructuring aid foreseen by the restructuring plan amounts to EUR 102.9 million, i.e. 69.8% of the restructuring costs. The company will contribute to the restructuring costs through the sale or transfer of assets at an estimated total value of EUR 54.46 million.
- (48) The restructuring plan envisages that the own contribution will be composed of the following items:

Table 4: Suggested own contribution

	Amount (in EUR million)	Estimated realisation date
Sale of two Airbus A319 aircraft	22.1	Concluded in April 2012

Sale of evening LHR slot	15	Under negotiation
Sale of morning LHR slot	10	Late 2014
Sale of spare parts	3.5	EUR 2.0 million in 2013; EUR 1.1 million in 2014; EUR 0.4 million in 2015
Sale of property in Nicosia	3.1	Concluded on 6 August 2013
Transfer of property in Athens to Provident Fund	0.76	Transfer agreement concluded in August 2013
<u>Total suggested own contribution</u>	<u>54.46</u>	

(49) As regards the concluded sales (two Airbus A319 aircraft, property in Nicosia), the Cypriot authorities have provided the sale contracts which confirm the amounts assumed by the restructuring plan. As regards non-realised sales, the Cypriot authorities have provided:

- a. A valuation study carried out by a specialised company regarding the two LHR slots. The study supports the assumptions of the restructuring plan as regards the morning LHR slot, but it values the evening LHR slot approximately EUR 2 million lower.
- b. A valuation study carried out by a specialised company regarding the property in Athens. The valuation supports the value, under which the property was transferred to the Provident Fund.

1.5.6. Compensatory measures

(50) The Cypriot authorities acknowledge that the restructuring aid to Cyprus Airways may distort competition. Thus, they propose to consider some of the afore-mentioned measures as compensatory measures, which can minimize the impact on competition and competitors. In particular:

- a. Discontinuing profitable routes representing 8.8% of ASK of 2012:¹² HER-SKG; LCA-FCO; LCA-LED; LCA-LED-PFO-LED-LCA; RHO-SKG-RHO.¹³ In addition, reduction of capacity on profitable routes: LCA-LON; LCA-ATH; LCA-SKG; LCA-HER. The Cypriot authorities consider that 24% of the AKS reduction will be related to profitable routes;
- b. Sale of the two LHR slots. Since LHR is a congested and attractive airport, the Cypriot authorities consider that these slots will provide sufficient compensation to potential competitors;
- c. Fleet reduction by 7 aircraft.

(51) Cyprus did not provide conclusive and complete information as to the profitability of the abandoned routes. Indeed, the summary data provided show that at least two of the routes (LCA-LED and RHO-SKG-RHO) did not even seem to cover their variable costs in 2012.

¹² As profitable routes the restructuring plan considers routes which have positive gross contribution to the company's costs, i.e. revenue minus variable cost.

¹³ PFO: Paphos (Cyprus).

1.6. Training aid

- (52) According to the Cypriot authorities during the period 2010-2011, Cyprus Airways received training aid of EUR 269,317.94 under the Scheme for constant training programmes for individual enterprises implemented by Cypriot Authorities pursuant to the GBER.

POSITION OF THE CYPRIOT AUTHORITIES

1.7. Restructuring aid and plan

- (53) The Cypriot authorities acknowledge that measures 2, 3 and 4 involve state aid within the meaning of Article 107(1) TFEU. They also include measure 1 in their notified restructuring aid, while maintaining their position that the measure does not involve state aid.
- (54) The Cypriot authorities also acknowledge that Cyprus Airways has been a firm in difficulty since 2009. Therefore, the Cypriot authorities have argued that the State support measures provided to the company should be assessed under the R Rescue and Restructuring Guidelines ('R&R Guidelines')¹⁴.
- (55) As regards the compatibility criteria, for the restoration of viability the Cypriot authorities point out that most of the measures will already take place in 2013 and 2014 and that the company will return to profitability as of 2015 and restore long-term viability by 2017, even according to the low case scenario. In their view, a restructuring period of between 5-6 years is in line with the Commission's case practice.¹⁵
- (56) They maintain that the assumptions of the restructuring plan as regards the development of costs and revenues are prudent and take into account the competitive situation and the general macro-economic risks. To that effect, they provide indications about the trend of the oil price and the USD/EUR exchange. As a further sign of prudence, the plan does not take into account other potential opportunities for cutting costs or enhancing revenue, such as electronic trading improvements and foreign investments.
- (57) Moreover, they note the geographic location of Cyprus, the fact that at least 50% of the country's population is located in regions eligible for regional investment aid under Article 107(3)(c) TFEU and that Cyprus Airways serves specific needs.
- (58) As regards the compensatory measures, the authorities claim that a reduction of more than 11% of profitable routes, a reduction of more than 50% of the fleet and the sale of slots in congested airports is consistent with case practice. In their view, this has to be assessed against the background of a small size airline, which would be jeopardizing its viability if it offered more compensatory measures, and the geographic location of Cyprus, for which the plane is almost the only means to transfer people to and from the island.
- (59) As to the aid limited to the minimum, the authorities point to an envisaged own contribution of EUR 54.46 million to the restructuring costs. In their view, this should be

¹⁴ Communication from the Commission – *Community guidelines on state aid for rescuing and restructuring firms in difficulty*, OJ C 2044, 1.10.2004, p.2.

¹⁵ Commission decision of 22 February 2006 in case N 464/2005, *restructuring aid in favour of AB Kauno ketaus liejykla*; Commission decision of 18 July 2001 in case NN 92/1999, *measures in favour of Zentrum Mikroelektronik Dresden AG – Sachsen*; Commission decision of 1 June 2005 in case N 584/2004, *restructuring aid to AB Vingriai* and Commission decision of 6 November 2008 in case C 19/2005, *restructuring aid for Stocznia Szczecińska*.

considered acceptable under the R&R Guidelines in cases of "*exceptional circumstances and [...] of particular hardship*" (point 44) and in light of relevant case practice.¹⁶ They also explain that the aid will not be used for expansion or an aggressive strategy of Cyprus Airways

- (60) Overall, the Cypriot authorities have explained the importance of air transport in general for the Cypriot economy, as well as the impact of a potential insolvency of Cyprus Airways to the economy of the island, in terms of income and job losses in the tourism sector overall. In addition, because of the high seasonality of the market, they believe that without Cyprus Airways, the island would not be connected to important destinations during the winter months.
- (61) The Cypriot authorities also put forward justifications for a derogation from the "one time, last time" principle of the R&R Guidelines (points 72-73), since the company received restructuring aid in 2007.¹⁷ They argue that there have been "*exceptional and unforeseen circumstances for which the company is not responsible*", which should allow for Cyprus Airways to receive additional restructuring aid. In particular, the exceptional and unforeseen circumstances are:
- a. The effect of the Greek and Cypriot crisis as unforeseen circumstances. To substantiate their argument, the authorities have provided data showing that there was a 3% drop of passengers from Greece since 2008, whereas there was a significant drop of the average fare price for the Greek destinations (approximately average price of EUR 80 in 2008 to EUR 50 in 2012);
 - b. The ban imposed by Turkey on Cypriot aircraft flying over its airspace since 1974. The ban affects mainly flights from Cyprus to the important markets of Russia (making the flight longer) and Ukraine, Armenia and Romania (making the flight entirely uncompetitive);
 - c. The operation of an "illegal" airport in the occupied northern part of Cyprus, which Turkish air carriers are allegedly using to bring tourists from European destinations to Cyprus;
 - d. Unrest in various destination countries in the Mediterranean (Arab Spring).
- (62) Finally, the Cypriot authorities invoke case practice and other legal arguments, which in their view indicate that the breach of the "one time, last time" principle is not a sufficient reason to consider further restructuring aid to a company as incompatible.¹⁸

1.8. Training aid

- (63) Contrary to their argumentation under the notified measures above, in their submissions regarding the training aid scheme (in particular the submission of 14 March 2013) the Cypriot authorities argued that Cyprus Airways was not in difficulty when the training aid in question was granted. The Cypriot authorities thus consider that the measure was compatible with the national training aid scheme, which is based on the GBER.

¹⁶ Commission decision of 24 April 2007 in case C46/2005, *Inter Ferry Boats*, OJ 2009 L 225/1.

¹⁷ C 10/2006 (ex N555/05), Decision of 7 March 2007, published in OJ L 49, 22.2.2008, p.25.

¹⁸ Commission Decision of 15 November 2010, State Aid No N 504/2010 – Malta, *Air Malta plc. – Rescue Aid.*; Opinion of Mr Advocate General Jacobs in Case C-110/02 *Commission v Council*, paragraph 43 [2004] ECR I-6333.

CONCERNS EXPRESSED BY COMPETITORS

- (64) In parallel to the pre-notification of the measures after July 2013, several competitors of Cyprus Airways expressed serious concerns regarding the apparently planned additional State support.
- (65) The competitors noted in particular that the planned measures would violate the standstill obligation and that they would constitute state aid, which would be incompatible with the Treaty, because they would violate the "one time, last time" principle of the R&R Guidelines. This is because Cyprus Airways had received compatible restructuring aid in 2007. They also raised concerns that the State support to Cyprus Airways was distorting competition, since other competitors of Cyprus Airways did not benefit from the same measures.

ASSESSMENT

1.9. Presence of state aid

- (66) By virtue of Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.
- (67) In order to conclude on whether state aid is present, it must therefore be assessed whether the cumulative criteria listed in Article 107(1) TFEU are met for the measures identified.
- (68) With regard to measure 1, in the decision of 6 March 2013, the Commission reached the preliminary conclusion that the market economy investor principle ('MEIP') is not complied with and therefore the measure constitutes an advantage that Cyprus Airways would not have received under normal market conditions. Since all the other conditions of Article 107 (1) TFEU are met, the measure constitutes a State aid (see recitals 49-70 of the decision of 6 March 2013).
- (69) For measures 2, 3 and 4, the Cypriot authorities have themselves notified them as state aid. The Commission agrees with this view.
- (70) Indeed, the debt-to-equity swaps (measures 2 and 3) involve additional State resources and provide a selective advantage to Cyprus Airways which sees an improvement in its economic situation. That is because the State is forgoing the collection of resources due to it. At the same time, the company does not have to repay its debts. No other creditor has carried out a similar swap. Therefore, those measures neither seem to comply with the MEIP, nor has Cyprus argued that they do.
- (71) As regards measure 4, the State will cover a deficit, which normally should be financed by the Company. Therefore, the measure involves additional State resources and provides a selective advantage to Cyprus Airways.
- (72) Finally, the training aid granted to Cyprus Airways in 2010 and 2011 was provided through a scheme, which allowed grants from the State budget to selected companies for training purposes.
- (73) All measures affect trade between Member States and have the potential to distort competition, since Cyprus Airways is in competition with other airlines in the European Union. The measures in question enable Cyprus Airways to continue operating so that it does not have to face, as other competitors, the consequences normally deriving from its poor financial results.

- (74) The Commission has reached the preliminary conclusion that measures 1, 2, 3, 4 and the training aid constitute state aid in favour of Cyprus Airways.
- (75) The Commission cannot take a position yet on the state aid qualification of a possible EUR 10 million short term loan, since the conditions have not been clarified by the Cypriot authorities.

1.10. Unlawful aid

- (76) The Commission notes that measure 1, as well as the training aid, were implemented in breach of the stand-still obligation pursuant to Article 108(3) TFEU. This is because measure 1 was disbursed already in 2012 and the training aid in 2010-2011.
- (77) As regards measures 2, 3 and 4, the Commission notes that the Cypriot State, in the context of its economic adjustment programme, has undertaken the commitment not to *"implement any measures involving State aid towards Cyprus Airways until the approval of a restructuring plan by the European Commission."*¹⁹ At this stage, the Commission has no conclusive information that the measures have been granted, whereas it is noted that the debt-to-equity swaps can anyway take place at a later stage and still be recorded in the financial statements of 2013.
- (78) Thus, the Commission considers that measure 1 and the training aid qualify as unlawful State aid and invites the Cypriot authorities to clarify whether or not the other measures have already been granted or indeed they are still at the planning stage.

1.11. Compatibility with the internal market

- (79) Insofar as the measures identified above constitute state aid within the meaning of Article 107(1) TFEU, their compatibility must be assessed in the light of the exceptions laid down in paragraphs 2 and 3 of that Article.
- (80) According to the case-law of the Court of Justice, it is up to the Member State to invoke possible grounds of compatibility and to demonstrate that the conditions for such compatibility are met.²⁰
- (81) The Cypriot authorities have argued that the measures 1, 2, 3 and 4 should be assessed with regards to their compatibility under Article 107(3)(c) TFEU and in particular under the R&R Guidelines, since Cyprus Airways has been a firm in difficulty at least since 2010. The Commission agrees with that view.
- (82) As regards the training aid, the Cypriot authorities have argued that the measure was compatible with the national training aid scheme, which was based on the GBER. However, the Commission notes that companies in difficulties are excluded from the scope of application of the GBER (Article 1(6)(c)). Since Cyprus Airways was a firm in difficulty at the time of the granting of training aid, the Commission will therefore assess that grant as part of the restructuring plan.

1.11.1. Eligibility – Difficulties of Cyprus Airways

- (83) Following the assessment carried out in the decision of 6 March 2013 (in recitals 41-460 above), as well as the acknowledgment by the Cypriot authorities, the Commission has reached the preliminary conclusion that Cyprus Airways was a firm in difficulty within

¹⁹ See The Economic Adjustment Programme for Cyprus Second Review - Autumn 2013, and in particular Memorandum of Understanding on Specific Economic Policy Conditionality, available at http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp169_en.pdf

²⁰ C-364/90 *Italy v Commission* [1993] ECR I-2097, para 20.

the meaning of points 10 and 11 of the R&R Guidelines since 2009 and continues to be a firm in difficulties at present.

- (84) Therefore, any state aid granted during that period has to be assessed based on the R&R Guidelines, since *"a firm in difficulty cannot be considered an appropriate vehicle for promoting other public policy objectives until such time as its viability is assured. Consequently, the Commission considers that aid to firms in difficulty may contribute to the development of economic activities without adversely affecting trade to an extent contrary to the Community interest only if the conditions set out in these Guidelines are met."* (point 20 of the R&R Guidelines).

1.11.2. Restoration of long-term viability

- (85) According to point 35 of the R&R Guidelines the restructuring plan, the duration of which must be as short as possible, must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions.
- (86) The restructuring plan forecasts that the company will restore its long-term viability by 2017 and that it will have positive EBIT and equity by 2014 in the base scenario and by 2016 in the low case scenario. The Commission has doubts whether those forecasts are realistic to achieve, because the restructuring plan seems to assume a favourable situation in the market and it is only subject to a very marginal sensitivity analysis, which does not reflect many of the apparent risks in the market and the macro-economic environment.
- (87) In particular, the effectiveness of the maintained route network, on which the profitability assumptions are based, is questionable. Cyprus Airways is already facing competition on the three routes, which have a positive EBIT (Sofia, Beirut and Tel Aviv) from at least one competitor and two competitors on the Moscow route.
- (88) The restructuring plan does not try to quantify in its projections the acknowledged risk that that competition in the Tel Aviv and Moscow routes may increase (e.g. by increase of frequency by the existing operator), nor does it factor in any potential further instability in the Middle East region.
- (89) In addition, the restructuring plan does not acknowledge any risk of increased competition by other strong players in the Cypriot market, which is a possibility that cannot be excluded and has already been mentioned by competitors in their comments after the decision of 6 March 2013.
- (90) The shifting from [...] to [...] is assumed to generate positive EBIT, but the restructuring plan does not seem to reflect the potentially lost transit options for passengers travelling further afield (e.g. to the USA). [...].
- (91) Two very important cost items for the airline industry, the variations in USD/EUR exchange rates and fuel prices are assumed stable. However, the restructuring plan admits that a negative variation of [0-2.5]% of either factor reduces results by EUR [0.2-0.7] million, which is the forecasted profit in the base case scenario for FY 2014.
- (92) Moreover, the restructuring plan does not reflect any potential reduction in passenger demand due to the elimination of catering in economy class. This could be the case for passengers who value the lunch option, which is offered by some of Cyprus Airways' competitors.
- (93) On the revenue side, the Commission notes that the restructuring plan does not take into account the recession in Cyprus, which may have a further bearing on the company's

main client base, while in any event many of the maintained routes have a negative EBIT and thus do not contribute to the company's profits.

- (94) At any rate, the restructuring plan focuses solely on cost cutting measures without addressing the fundamental business model of the company that so far has not proven viable for Cyprus Airways. All potential improvements of revenue streams adopted by other small and medium airlines under restructuring in the EU (e.g. introduction of more efficient points of sales without intermediary agents, introduction of ancillary fees, new advertisement campaign) are not concretely envisaged by the restructuring plan of Cyprus Airways and they are not reflected in the restructuring costs.
- (95) The envisaged financial results provided by the restructuring plan indicate a strong performance at the end of the restructuring period. However, the Commission observes that the relatively high ROE and ROCE ratios in Table 2 are the result of a ratio with a very small denominator (equity). The Commission has doubts whether such marginal EBIT and low equity are signs of viability, especially in a sector which is affected by tough competition and sudden operating costs rises. In addition, a company with zero capital reserves and negative total reserves (as would be Cyprus Airways at the end of the restructuring period, according to the restructuring plan) may not be considered viable, since the safety margin will be effectively inexistent.
- (96) The Commission also doubts the impact of some of the cost cutting measures, because they are assumed without taking into account any potential difficulties of implementation outside the control of the company. This is for example the case regarding the renegotiation of the parking fees at the Larnaca airport. In addition, the Cypriot authorities did not clarify whether the reduction of the ground handling fees will be achieved, since it seems to be subject to payment by Cyprus Airways of an outstanding debt towards the ground handling company.
- (97) Finally, the restructuring period is longer than the restructuring periods in recently approved airline cases (Air Malta, Czech Airlines), which was as a maximum 5 years.²¹ It is also noted that the restructuring plan does not cover the period, during which aid was given, since Cyprus Airways already received grants for training in 2010 and 2011.
- (98) Against this background, the Commission invites the Cypriot authorities to provide an updated profitability and sensitivity analysis of the restructuring plan, in view of the doubts expressed above and justify why such a long restructuring period is necessary. It also invites the Cypriot authorities to update the timing of the restructuring measures, since their submission of 10 January 2014 indicates that the implementation schedule is delayed. The Commission invites interested parties to comment on the matters described above.

1.11.3. Avoidance of undue distortion of competition

- (99) According to point 38 of the R&R Guidelines, compensatory measures must be taken in order to ensure that the adverse effects on trading conditions are minimized as much as possible. In this regard, closure of loss-making activities which would at any rate be necessary to restore viability will not be considered reduction of capacity or market presence for the purpose of the assessment of the compensatory measures (point 40 of the R&R Guidelines).

²¹ Decision C(2012) 6352 final of 19.09.2012 concerning the case SA.30908 CSA - *Czech Airlines - Restructuring plan*, OJ L/92/2013; Decision C(2012) 4198 final of 27.06.2012 concerning the case SA.33015 *Air Malta plc*, OJ L/301/2012.

- (100) The Cypriot authorities have provided very limited and inconclusive information as regards the profitability of these routes and the amount of ASK that they represent, whereas at least two routes seem to be loss making, as they did not have a positive gross contribution.
- (101) The Commission therefore invites interested parties to comment on the proposed compensatory measures. The Commission also invites the Cypriot authorities to substantiate that the proposed routes consist adequate compensatory measures within the meaning of the R&R Guidelines or propose other compensatory measures.

1.11.4. Aid limited to the minimum – Own contribution

- (102) According to point 43 of the R&R Guidelines, in order to limit the amount of aid to the strict minimum of the restructuring costs necessary, a significant contribution to the restructuring plan by the beneficiary from its own resources is necessary. Such contribution must be actual and includes the sale of assets that are not essential to the firm's survival, or external financing at market terms.
- (103) Firstly, the Commission notes that Cyprus Airways envisages to contribute EUR 54.46 million as own contribution which corresponds to 36.9% of the restructuring costs. Since the restructuring costs are 147.4 million, the Commission doubts that the notified restructuring aid of EUR 102.9 million can be considered as limited to the strict minimum, since the sum of the own contribution and the restructuring aid is higher than the restructuring costs.
- (104) Secondly, for large firms, the Commission normally considers a contribution to the restructuring of at least 50% to be appropriate. However, in exceptional circumstances and in cases of particular hardship, the Commission may accept a lower contribution (point 44 of the R&R Guidelines).
- (105) In assisted areas the conditions for authorising aid may be less stringent as regards the size of the beneficiary's contribution (point 56 of the R&R Guidelines). However, only some regions of Cyprus are eligible for regional investment under Article 107(3)(c) and the Cypriot authorities did not clarify whether these regions include the seat of Cyprus Airways.
- (106) However, the own contribution in the present case of 36.9% would in principle appear to be insufficient as the Commission generally requires an own contribution of at least 40% from large companies situated in assisted areas. For instance, in the case of Air Malta, which presented similar features, the own contribution proposed by the company and accepted by the Commission was 45.5% of the restructuring costs.
- (107) Thirdly, the Commission notes that, as regards actual contribution through the sale of assets, the sale of the spare parts has not been concluded and the value envisaged to be collected is not supported by any evidence. The sale of the LHR slots has also not been concluded and the evening LHR slot is valued by the study, provided by the Cypriot authorities, for a price lower than the one foreseen in the restructuring plan. In addition, the transfer of the property in Athens to the Provident Fund does not seem to constitute an actual contribution, since the Provident Fund seems to be an integral part of Cyprus Airways and its liabilities.
- (108) The Commission therefore doubts that point 43 of the R&R Guidelines is fulfilled. Against this background, the Commission invites the Cypriot authorities to justify that the contemplated restructuring aid is limited to the minimum necessary and to explain why an own contribution lower than that of comparable companies should be accepted.

Finally, the Commission invites the Cypriot authorities to clarify the value and purpose of the elements of the own contribution and invites interested parties to comment on this matter.

1.11.5. "One time, last time" principle

- (109) Section 3.3 of the R&R Guidelines stipulates that rescue and/or restructuring aid should be granted only once and *"where less than 10 years have elapsed since the rescue aid was granted or the restructuring period came to an end or implementation of the restructuring plan has been halted (whichever is the latest), the Commission will not allow further rescue or restructuring aid."* This condition is known as the "one time, last time" principle.
- (110) As Cyprus Airways has received compatible restructuring aid in 2007 on the basis of a restructuring plan, Cyprus Airways is therefore in principle not eligible for further restructuring aid at present according to the "one time, last time" principle.
- (111) The R&R Guidelines (point 73) foresee an exception of the "one time, last time" principle: "
- a. where restructuring aid follows the granting of rescue aid as part of a single restructuring operation;*
 - b. where rescue aid has been granted in accordance with the conditions in section [3.1], and this aid was not followed by a State supported restructuring, if*
 - i. the firm could reasonably be believed to be viable in the long-term following the granting of rescue aid, and*
 - ii. new rescue or restructuring aid becomes necessary after at least five years due to unforeseeable circumstances [25] for which the company is not responsible;*
 - c. in exceptional and unforeseeable circumstances."*
- (112) As regards point 73(c), the Commission recalls its findings in recitals 89-99 of the decision of 6 March 2013 as regards the Turkish overflight ban and the unrest in the Middle East.
- (113) The operation of an airport in the northern part of Cyprus also cannot be considered as exceptional and unforeseen, as the possibility for tourists to cross the border towards Cyprus appears to have been in place at least since 2004.
- (114) As regards the economic situation in Cyprus and Greece, the Commission does not contest the existence of deterioration in the Cypriot and Greek economies and recalls its argumentation in the decision of 6 March 2013 (see recitals 84-85 of that decision).
- (115) The Commission recalls recitals 85-87 of the decision of 6 March 2013. In this connection, the commission stresses that the Cypriot authorities have not yet provided conclusive evidence, which would substantiate the exceptional and unforeseeable effects of the Greek and Cypriot recessions, as well as the unrest in the Middle East, on Cyprus Airways.
- (116) Indeed, the available evidence rather suggests that the traffic reduction from Greece was marginal.-The restructuring plan shows that total passenger numbers through Larnaca have been nearly stable since 2010, whereas Paphos has increased its passengers. This

shows that overall Cyprus does not seem to have lost passenger traffic during the period in question.

- (117) At the same time, the information available to the Commission shows that Cyprus Airways did not make the necessary adjustments to its business, in order to avoid the effect of the deterioration in the Greek economy, which it considers a traditional destination. To the contrary, the company expanded its domestic flights in Greece between 2011-2013, and was thus consciously increasing its exposure to the Greek market.
- (118) In conclusion, the Commission has doubts at this stage whether any exception to the "one time, last time" principle can be applied and invites the Cypriot authorities and interested parties to provide comments on the arguments described above.

1.11.6. Conclusion on compatibility

- (119) In view of the above, the Commission has doubts on the compatibility of measures 1, 2, 3, 4 and the training aid with the internal market.

In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union, requests Cyprus to submit its comments and to provide all such information as may help to assess the measures, within one month of the date of receipt of this letter. It requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

In view of the fact that certain measures under this decision have already been the subject of the formal investigation procedure initiated with the decision of 6 March 2013, the Commission envisages reaching a conclusion on both formal investigation procedures with a common decision.

The Commission wishes to remind Cyprus that Article 108(3) of the Treaty on the Functioning of the European Union has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns Cyprus that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the *Official Journal of the European Union* and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
1049 Brussels
Belgium

Fax No: +32-2-296-1242

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-president

NOTICE FOR PUBLICATION IN THE OJ, C SERIES
(decisions to initiate the formal investigation procedure)

STATE AID – Cyprus

STATE AID SA.37220 (2014/C) (ex 2013/NN)
Restructuring aid for Cyprus Airways (Public) Ltd and SA.38225 (2014/C) (ex 2014/NN)
Training aid for Cyprus Airways (Public) Ltd

**Invitation to submit comments pursuant to Article 108(2) of the Treaty on the
Functioning of the European Union.**

Text with EEA relevance

By means of the letter dated [XX.XX.2014] reproduced in the authentic language on the pages following this summary, the Commission notified Cyprus of its decision to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union concerning the abovementioned aid.

Interested parties may submit their comments on the aid within one month of the date of publication of this summary and the following letter, to:

European Commission
Directorate-General for Competition
State Aid Registry
1049 Brussels
Belgium
Fax No: +32-2-296-1242
E-mail: stateaidgreffe@ec.europa.eu

These comments will be communicated to Cyprus. Confidential treatment of the identity of the interested party submitting the comments may be requested in writing, stating the reasons for the request.

[Text of summary]

Procedure

On 23 October 2013, Cyprus notified a restructuring aid for Cyprus Airways (Public) Ltd. ("Cyprus Airways", "the Company") in the amount of EUR 102.9 million. The Commission asked for additional information on the restructuring aid notification on 15 November 2013 to which Cyprus replied on 10 January 2014. In addition, the Commission also investigates the application of a scheme for training aid to Cyprus Airways under SA.38225 (2014/C ex 2014/NN).

Description of the measure

The restructuring aid takes the form of an equity investment. It consists of (i) a EUR 31.3 million share capital increase by the State (already granted in 2012); (ii) a EUR 34.5 million debt-to-equity swap of the rescue loan granted by the State during the first half of 2013; (iii)

calling of State guarantee for a loan by Hellenic Bank for the outstanding amount of the loan (EUR 28.5 million), and the subsequent conversion of that amount into equity; (iv) a EUR 8.6 million capital injection by the State to cover part of the deficit of the Provident Fund. In addition, according to the Cypriot authorities during the period 2010-2011, Cyprus Airways received training aid of EUR 269,317.94 under the Scheme for constant training programmes for individual enterprises implemented by Cypriot Authorities pursuant to the GBER.

Assessment of the measure

Both the Commission and Cyprus considers that Cyprus Airways is a firm in difficulty in the sense of the Rescue and Restructuring Guidelines²² ("the Guidelines").

Since the restructuring aid is provided from State resources, it provides Cyprus Airways with a selective advantage, it distorts or threatens to distort competition and affects trade between Member States, the Commission considers that it constitutes State aid within the meaning of Article 107(1) TFEU. The Cypriot authorities do not dispute the classification of the measure as State aid.

In relation to compatibility, the Commission considers that, in view of the nature of the measure and of the difficulties of Cyprus Airways, the only relevant criteria of assessment appear to be those concerning aid for rescuing and restructuring firms in difficulty under Article 107(3)(c) TFEU on the basis of the Guidelines. At this stage the Commission has doubts whether the conditions laid down in the Guidelines have been met.

In particular, the Commission will investigate whether Cyprus Airways complies with the "one time, last time principle" since the company has already received restructuring aid of EUR 118.6 million which was approved in 2007²³.

Furthermore, the Commission has doubts whether the restructuring plan submitted by Cyprus is capable of restoring long term viability of Cyprus Airways.

The Commission has also doubts whether the own contribution and compensatory measures of Cyprus are sufficient enough to be in line with the Guidelines.

As regards the training aid, since Cyprus Airways seem to have been a company in difficulty at the time of granting, the compatibility of the training aid grants seems doubtful.

For the reasons stated above the Commission has doubts about the compatibility of the notified measure with the internal market and has accordingly decided to open the formal investigation procedure.

²² Community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C 244, 1.10.2004, p. 2.

²³ Commission Decision C (2007) 300, concerning case SA.20100 (C 10/06), OJ L 49, 22.02.2008, p. 25.

[Text of letter]