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Subject: SA.30908 (N 176/2010) CSA - Czech Airlines - Restructuring plan

Sir,

The Commission wishes to inform the Czech Republic that, having examined the information supplied by your authorities on the measure mentioned above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the functioning of the European Union.

1. PROCEDURE

1. On 12 May 2010, the Czech authorities notified State aid for the restructuring of the company České aerolinie a.s. (hereinafter referred to as "Czech Airlines" or "the company")¹.
2. By letter dated 6 June 2010,² the Commission asked for supplementary information. A request for prolongation of the submission deadline, registered by the Commission on the 2 July 2010, was accepted by the Commission services on

¹ SANI 4435.

² D/8064.

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3 July 2010 until 15 September 2010. On 15 September 2010 and 24 September 2010, the Czech authorities submitted further information³.

3. In November 2010, the Commission became aware through press articles that the Czech authorities intended to merge Czech Airlines with the Letiště Praha, a. s. (hereinafter referred to as "Prague Airport"). During a meeting on 29 November 2010, the Czech authorities confirmed this information and transmitted the Government Resolution No 848 of 24 November 2010 (hereinafter referred to as "Government Resolution"), by which the Government approved the creation of a holding comprising Czech Airlines and Prague Airport.
4. On 25 November 2010,⁴ the Commission services requested additional information. On 15 December 2010, the Czech authorities provided a partial answer⁵ and requested a prolongation of the deadline for remaining questions.

2. CZECH AIRLINES – THE BENEFICIARY

Description of the Company

5. Czech Airlines is the Czech national air carrier. It was founded in 1923 and is based at Prague Ruzyně airport (PRG). Czech Airlines is a state-owned company. Before the capital increase in June 2010, 91.75% of shares were owned by the Czech Republic through its Ministry of Finance. Minority shareholders included Česká pojišťovna a.s.⁶ (4.33%), Capital City of Prague (2.94%) and Capital City of Bratislava (0.98%). In June 2010, on the basis of Government Decree No 333 of 3 May 2010, a capital increase took place through a debt-to-equity swap. The capital increase of CZK 2.5 billion was subscribed by the State through the Ministry of Finance alone. No other shareholders participated in this operation.
6. Two attempts to bring a strategic partner into the company have been made in the past. In 1992, Air France acquired 19% of the shares in Czech Airlines, but disposed of them again in 1994. In April 2009, a tender for the sale of the state's equity stake in Czech Airlines was held, but as no adequate bid was submitted to the government, the Czech Government eventually instructed the Finance Minister to cancel the tender in October 2009.

Business activities

7. The main business of Czech Airlines is scheduled air transport of passengers. In 2010, in this segment Czech Airlines operated a fleet of 44 aircrafts on scheduled flights to 67 destinations in over 40 countries in Europe, the Middle East, Central Asia and North Africa. Since 2000, Czech Airlines has been a member of the Sky Team alliance⁷.

³ A/12384.

⁴ 111969.

⁵ 121791.

⁶ Česká pojišťovna a.s. is a Czech insurance company.

⁷ The Sky Team Alliance consists of European (e.g. Air France-KLM, Alitalia, Aeroflot etc.) and global carriers (e.g. Delta-NorthWest, Korean Air etc.).

8. On the scheduled air transport of passengers market, Czech Airlines face competition in particular from the Lufthansa group, British Airways, Swiss Air and Air France. In terms of size and capacity, Czech Airlines does not come close to its main competitors in the FSC (Full-Service Carrier) sector, and also faces strong competition on most of its direct connections from low-cost carriers (LCCs) (Travel Service, Wizzair, and Ryanair flying from Prague airport).
9. In 2009 Czech Airlines carried 4.7 million passengers which corresponded to revenues of CZK 15.6 billion. [...] % passengers flying with Czech Airlines were transfer passengers travelling on multi-segment flights within the Czech Airlines network.⁸ It is the largest airline based at Prague Airport, accounting for 37% of the passengers who originate or finish their trip in Prague.
10. According to the Czech authorities, Czech Airlines market shares in 2009 were below [...] % for 19 routes, between [...] % for 24 routes, and exceeded [...] % for 24 routes.⁹ Czech Airlines is the sole direct operator on [...] routes, mainly to the Central and Eastern Europe and Central Asia. By operating a number of regional routes, Czech Airlines provide passengers with an alternative to services by carriers from the Star Alliance.
11. In 2009, Czech Airlines cancelled all of its long-distance routes. Indeed, routes to Toronto and NY JFK were cancelled at the beginning of the summer travel season of 2009. This represented a capacity decrease of 1.1 million ASK. Currently, the company is active only on the short-distance and medium-distance route segments.
12. In addition to its scheduled operations, Czech Airlines offers through its organisational departments or subsidies a number of other services.
13. First, Czech Airlines provide charter flights. In 2009, Czech Airlines transported 0.756 million charter passengers, which correspond to a market share of around [...] %. In this segment it competes with Travel Service a.s. (estimated market share of 50-55%) and a number of other smaller charter airlines operating from Prague Airport, e.g. Grossman Jet, ABS Jet, Silesia Air and several others with several percent market shares.
14. Second, Czech Airlines carries out aircraft maintenance through its department, Technical Department (Technický úsek, MRO), which is certified to perform light and heavy maintenance on all Boeing B737 and Airbus A320 family aircrafts. It also performs extensive checks on ATR 42/72 aircraft, and has certificates for checks on Airbus A310 aircraft. This department mainly serves Czech Airlines, however, [...] % of the revenue comes from services provided to third parties, e.g. [...].

* Business secret.

⁸ Defined as one passenger per one flight leg, i.e. a passenger taking a flight consisting of two legs is counted as two passengers.

⁹ Market being defined as direct and indirect flights between a particular point of origin and a point of destination pair (O&D).

15. In this segment, Czech Airlines faces competition from several providers in Central and Eastern Europe, e.g. Aeroplex, MRO - the former Malév maintenance facility with facilities in Budapest, Hungary, and Sofia, Bulgaria, performing comprehensive light maintenance on Boeing B737.
16. Third, Czech Airlines provides cargo transport onboard its passenger aircrafts, and also represents other airlines (Korean Air, Delta Air Lines) when selling cargo capacity on routes not operated by Czech Airlines to a number of clients, including DHL Logistics, Schenker, FedEx, TNT, UPS or Kuehne Nagel. Czech Airlines does not operate any specialized cargo aircrafts. All passenger carriers operating in the region as well as some specialized cargo operators are providing cargo transport onboard their passenger aircraft in a similar manner to Czech Airlines.
17. Fourth, Czech Airlines Handling, s.r.o. provides passenger and aircraft handling services, and cleaning of aircraft and buildings as well as ground transport service both for Czech Airlines and other airlines operating scheduled flights to and from Prague. Czech Airlines covers the entire aircraft cleaning market at the Prague Airport. The revenues from this activity amounted to CZK 148 million in 2009. In handling, Czech Airlines competes at Prague-Ruzyně airport with Prague Airport and Menzies Aviation. The revenues from handling amounted to CZK 964 million in 2009. When considering services provided to airlines other than Czech Airlines, these two handling companies have more than a [...] % share in movements, and over [...] % of the number of passengers transported in the Prague Airport market.
18. Finally, Czech Airlines have a majority stake in a number of companies, specifically:
 - Amadeus Marketing ČSA, s.r.o. (65% ownership), which supply of the Amadeus global distribution system for the Czech and Slovak Republics;
 - ČSA Services s.r.o. (100%), which operates a call centre and a recruitment centre, 97% of its services were provided to Czech Airlines;
 - Holidays Czech Airlines, a.s. (100%), providing inbound and outbound tourism services, 76% of its revenues came from third party business;
 - Slovak Air Service (100%); and
 - ClickforSky (100%);

Financial situation¹⁰

19. The financial situation started deteriorating in late 2008. In 2009, Czech Airlines observed losses of close to CZK 4 billion, prior to the inclusion of extraordinary revenue from asset sales, and was not able to cover them with asset disposal or other internal financing sources.

¹⁰ The following chapter contains the most recent data available to the Commission in this moment.

20. Table 1: Key financial indicators on the performance of Czech Airlines in 1st semesters 2007, 2008 and 2009

According to International Financial Reporting Standards in 1 000 CZK	01/2007 - 06/2007	01/2008 - 06/2008	01/2009 - 06/2009
Operating Cash Flow	516.260	587.995	[...]
EBIT	-621.512	196.152	[...]
Long term debts *	8.825.960	7.744.302	[...]
Short term debts **	8.529.858	7.375.896	[...]
Own capital	5.465.240	7.145.207	[...]
Short term assets ***	5.019.354	4.735.123	[...]
Long term assets ****	17.801.704	17.530.283	[...]
Working capital	-3.510.504	-2.640.774	[...]

* Long-term debts include provisions for liabilities and charges, long-term liabilities, long-term finance lease obligations, long-term bank loans and deferred tax liabilities.

** Short-term debts include short-term liabilities, short-term bank loan, short-term finance lease obligations, provisions for liabilities, charges and tax and other liabilities.

*** Short-term assets include inventories, short-term receivables, current financial assets and other assets.

**** Long-term assets include fixed assets, long-term receivables and other assets.

21. Comparing the financial indicators for the first semesters, an increase in the operating expenses resulted in a deterioration in the EBIT (Earnings before interest and taxes) from CZK 196.2 million (01/2008 – 06/2008) to CZK [...] million (01/2009 – 06/2009) while over the same period the long term and short term debts of Czech Airlines increased by [...] % to [...] %¹¹ and the own capital of Czech Airlines decreased by [...] % at the end of June 2009.
22. Thus, the debt-to-equity ratio¹² increased from 212 % in June 2008 to [...] % in June 2009 and the equity ratio¹³ decreased from 32 % in June 2008 to [...] % in June 2009. The average risk premiums charged to Czech Airlines increased from [...] % p. a. in 2007 to [...] % in 2008 and to [...] % in June 2009. The balance sheet also clearly shows the high asset intensity¹⁴ of the company ([...]).
23. The working capital¹⁵ decreased by [...] % and resulted in a negative figure of CZK [...] million, a figure which considering the size of the company can be seen as critical. Furthermore, the low value of the current ratio¹⁶ of [...] indicates that

¹¹ The debt position in June 2009 already includes the Osinek loan.

¹² Debt-to-equity ratio equals to total debt divided by shareholders' equity. It indicates the leverage used to finance the total assets; the higher the leverage, the higher the risk of bankruptcy.

¹³ The equity ratio is indicating the proportion of equity used to finance all of company's assets.

¹⁴ The asset intensity ratio is calculated by dividing long-term assets by the balance sheet amount (total liabilities plus own capital which equals the total assets). It shows which percentage of the capital at the disposal of the company is locked in long-term.

¹⁵ Working capital ratio is calculated as short-term assets minus short-term liabilities. Positive working capital means that the company is able to pay off its short-term liabilities. Negative working capital means that a company is unable to meet its short-term liabilities with its current assets (cash, accounts receivable and inventory), what mean that the company may have difficulties pay back creditors in the short term and may enter into bankruptcy in the worst case scenario.

¹⁶ The "current ratio" is calculated by dividing current assets by current liabilities, a current ratio of 1.0 means that the company is able to pay its short term liabilities from its current assets.

Czech Airlines will have substantial difficulties in meeting its current obligations. In addition, the short term debts are at the same level as the amount of long term debts. Due to the on-going financial and economic crisis further negative impacts on the operational performance of Czech Airlines and its financial results during 2009 could not be excluded. The cash flow development is shown in Table 2.

24. Table 2: Development of the cash flow of Czech Airlines

in 1 000 CZK	31 Dec 2007	30 June 2008	31 Dec 2008	31 March 2009	30 June 2009
Cash flow from operating activities	- 275.234	[...]	- 1.762.376	[...]	[...]
Cash flow from investing activities	1.499.599	[...]	1.883.704	[...]	[...]
<i>sale of assets</i>	1.584.115	[...]	1.768.940	[...]	[...]
Cash flow from financing activities	- 1.687.852	[...]	- 76.189	[...]	[...]
Increase/decrease of cash	- 463.487	[...]	45.139	[...]	[...]
Cash balance	497.533	[...]	542.672	[...]	[...]

25. An examination of the company's cash flow calculation clearly reflects the impact of the financial and operational underperformance. The cash flow from operating activities has been decreasing since 2007 and resulted in CZK [...] million at the end of June 2009. The overall negative cash flow (decrease of cash) by end of March 2009 amounted to CZK [...] million (including the revenue from sales of assets amounting to CZK [...] million; the overall cash flow would be even more negative without the sale of assets). Since 2007 Czech Airlines has met its short-term financial needs through the sale of assets, mainly real estate, thus the cash income from the sale of assets has been balancing the negative operating cash flow. For the end of the year 2009 a further dramatic decrease in the liquidity was expected.

26. Table 3: Key financial indicators from the annual reports of Czech Airlines

In 1000 CZK	2006	2007	2008	2009	2010
registered capital	2 735 510	2 735 510	2 735 510	2 735 510	5 235 510
profits/losses	-396 951	206 600	470 057	-3 756 125	Information not available
Cash flow from operating activities	-533 192	-275 234	-1 762 376	-3 066 694	
Cash flow from investing activities	-160 341	1 499 599	1 883 704	996 322	
<i>sale of assets</i>	1 584 115	352 300	1 768 940	1 476 385	
Cash flow from financial activities	325 136	1 687 852	-76 189	2 087 218	
debt <i>long term liabilities</i>	92 752	15 605	168 126	59 443	
<i>short term liabilities</i>	3 734 929	3 677 336	5 659 707	6 267 745	
asset value	11 679 439	10 161 647	10 418 571	7 948 571	
own capital	938 646	1 238 093	101 686	-2 352 045	

27. While in 2007 and 2008 Czech Airlines still achieved profits of CZK 206.6 million and CZK 470 million, in 2009 it suffered losses of CZK 3 756 million. Moreover, the negative cash flow of CZK 3 066.7 million was only partially

According to International Financial Reporting Standards in 1 000 CZK	01/2007 - 06/2007	01/2008 - 06/2008	01/2009 - 06/2009
(a) Short term assets	5.019.354	4.735.123	[...]
(b) Short term debts	8.529.858	7.375.896	[...]
(a) / (b) Current (liquidity) ratio	0,59	0,64	[...]

compensated by sale of assets worth CZK 1 476.4 million. The loan from Osinek of CZK 2 500 million was from a large portion used to cover the negative cash flow from operation activities. The asset value fell in 2009 by CZK 2 470 million to CZK 7 948.6 million. The majority of the registered capital¹⁷ disappeared already before the end of 2006, when from the registered capital of CZK 2 735.6 million only CZK 938.6 million was remaining on the balance sheet in the form of own capital¹⁸ corresponding to 34.3% of the registered capital. In 2007, the value of own capital slightly increased to CZK 1 238 million (45.3% of the registered capital), just to fall again to 101.7 million (3.7% of the registered capital). As a consequence of the large losses, the registered capital of Czech Airlines disappeared before the end 2009 and the own capital value was negative: CZK -2 352 million (-86% of the registered capital).

28. Czech authorities submit that, in light of the developments described above, Czech Airlines can be considered as a firm in difficulties in the meaning of the Rescue and Restructuring Guidelines starting from August 2009, which is when the management had learned of the growing losses and diminishing cash flow in the first half of 2009; therefore, as of August 2009, Czech Airlines' management adopted measures for the initiation of a restructuring process.
29. The Czech authorities claim that while Czech Airlines' financial situation deteriorated as a consequence of the global economic recession as early as late 2008, Czech Airlines had reason to believe that significantly better results should be achieved in the 2009 summer season, when revenues in the airline industry commonly peak. Based on this prognosis, supported by its experience from previous years, Czech Airlines expected that it would create sufficient reserves to enable it to stabilize cash flow and prevent further losses.
30. Nonetheless, 1st semester 2009 results, reported to the management in mid-August, showed a significant decline in average revenue of Czech Airlines in June. It became clear that the company was no longer able to run its business without immediate cost-cutting measures and financial assistance from external sources. The company's Board of Directors thus established a working group, instructed to prepare the company's restructuring process. The plan to be prepared was expected to propose measures to be taken by Czech Airlines in response to the dramatic decline in demand for services in the industry, with an emphasis on savings to be achieved in terms of staffing capacity and a reduction of the fleet. Therefore, in August 2009, the focus of Czech Airlines moved from day-to-day operational measures to the overall restructuring of the company's business.

"Merger" with Prague Airport

31. In the Government Resolution, the government of the Czech Republic ordered establishing a public limited company Český Aeroholding, a.s. (hereinafter "Czech Aeroholding") and to transferring to it Czech Airlines as well as Prague

¹⁷ Registered capital is the original investment of the shareholders represented by the nominal value of all issued shares.

¹⁸ Own capital is the difference between assets and liabilities. If the own capital is negative, this means that the registered capital is disappearing.

Airport (see also point 3). This measure will be hereinafter referred to as the "merger". In the same resolution the Czech government ordered upon the completion of restructuring of Czech Airlines, and at the latest within three years, to prepare the sale of the Ministry of Finance's stake in Czech Airlines or an entry of a strategic partner into Czech Airlines. The Czech authorities informed the Commission that the precise terms of the "merger" were not yet decided. Once they will be decided, the merger will be first assessed by the Czech competition authority and if the merger falls within the scope of the EU Merger Regulation¹⁹ it will be notified to the Commission.

3. THE RESTRUCTURING PLAN

32. In the formal investigation procedure SA.29864 (ex C 6/2010)²⁰, the Commission expressed its doubts on whether the Osinek loan constitutes State aid and if yes, whether it constitutes rescue or restructuring State aid or other form of state aid. Without prejudice to the outcome of the procedure SA.29864, the Czech authorities submit that, if the Commission concludes on presence of aid in the Osinek loan, the latter forms a part of a single restructuring operation including all the notified measures.
33. The preparation of the restructuring plan started in August 2009. The implementation of the first measures included in the plan followed in the second half of 2009. In 2009, the staff costs were reduced in two steps, and the Duty Free department as well as APC building with related and surrounding land were sold.

3.1. State aid notified

34. The notified State aid consisted of the combination of the following three distinct measures:
- 1) *Osinek loan*. Favourable interest rate with respect to a loan with a total amount of CZK 2.5 billion from the state owned company Osinek a.s. which is a subject of the ongoing formal investigation procedure (hereinafter referred to as "Osinek loan"). The Czech authorities for the time being mention a potential State aid element in this transaction of CZK 92 million. In the notification the Czech authorities reiterated their argument that the Osinek loan does not constitute State aid in the meaning of Article 107(1) of the TFEU. However, given that the Commission expressed its doubt about the classification as State aid and the compatibility of this measure, the Czech authorities included the Osinek loan in the notification in the framework of the overall rescue and restructuring plan. Hence, the Czech authorities underlined that this measure shall only be taken into account in the framework of the notified restructuring plan in case the Commission will in its formal investigation procedure SA.29864 conclude on the existence of State aid.

¹⁹ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ L 24, 29.1.2004, p. 1.

²⁰ Commission Decision C(2010)987fin of 24.2.2010 in the case State aid NN 1/2010 (ex CP 371/2009) – Czech Republic ČSA – Czech Airlines a.s. – possible State aid implications of a loan provided by Osinek a.s., OJ C 43, 11.2.2011, p. 6.

- 2) *Debt-to-equity swap*. De-collateralisation of the above mentioned loan and its capitalisation, which was implemented as of 30 June 2010 on the basis of Government Decree. In this process, all mortgage rights relating to the Osinek loan were lifted and the liability of CZK 2 500 million resulting from the loan was counted towards newly issued shares in the same nominal value (hereinafter referred to as "debt-to-equity swap"). The Czech authorities consider that the aid element in this transaction amounts to up to CZK 2.5 billion.
- 3) *Potential State aid for financing of aircraft purchase*. In 2005, Czech Airlines ordered 8 Airbus (A319-100) aircrafts. By the fourth addendum to the contract, the purchase was rescheduled in the following way: [...] airplane in May 2011, [...] in [...] and [...] in [...]. The Czech authorities informed the Commission that only [...] airplane shall be purchased during the restructuring period. This purchase shall be financed through a bank credit guaranteed by the Exportní garanční a pojišťovací společnost (hereinafter referred to as "EGAP"). The Czech authorities expect that up to 70% of this purchase price will be financed through the loan that will be potentially covered by a state guarantee up to 80%. The guaranteed amount should therefore according to the Czech authorities not exceed CZK 500 million (hereinafter referred to as "aid for aircraft purchase"). Czech authorities stated that this aid will be used only in case that Czech Airlines will be unable to finance the purchase from its own resources or from commercial loans.

35. The first two measures were already executed, while the Czech authorities consider the last measure as an option to be granted in 2011. The first measure, the Osinek loan, as well as some modifications in the collateralisation of the loan are, following to the *Commission Decision C(2010)987fin of 24.2.2010 in the case State aid NN 1/2010 (ex CP 371/2009) – Czech Republic ČSA – Czech Airlines a.s. – possible State aid implications of a loan provided by Osinek a.s.*, subject of the ongoing formal investigation procedure SA.29864 (ex C 6/2010).

3.2. Restructuring measures

36. The Czech authorities notified a restructuring plan, which they updated in the subsequent submissions of information. The restructuring plan concentrates on measures concerning the company's core business, the scheduled air passenger transport. Other business sectors are either foreseen to be sold, to be outsourced within the structure of the future holding or their future development is not mentioned in the plan.
37. The restructuring plan covers the period from the second half of 2009 until the expected return to viability at the end of 2012.
38. The following circumstances that led to the Czech Airlines' difficulties are described in the restructuring plan. Czech Airlines reacted to market growth by a network expansion in 2004-2006. In 2006-2008, the expansion of low cost carriers forced Czech Airlines to rely strongly on transferring passengers. Facing higher costs in this segment, the revenue growth did not match the capacity expansion, resulting into operating losses. Czech Airlines entered the global market recession with an oversized fleet and therefore uncompetitive cost base. In

2009 the total number of passengers in Prague Airport dropped by over 6% and the average ticket revenue per passenger of Czech Airlines by 10% as compared to 2008. Moreover, the fuel price escalated rapidly in 2008-2009. Czech Airlines hedged the 2009 fuel prices and lost further CZK 1.6 billion due to this unsuccessful operation.

39. The improvement in viability in the plan derives from operational and structural measures. The operational measures include:
 - *Optimised Network Model and Fleet Rightsizing.* Czech Airlines will put more emphasis on direct point-to-point flights. It will reduce the number of destination with the lowest profits. The expected reduction of passenger traffic measured in passenger-kilometres (RPK) as compared to 2009 is 25%, while the revenue per available seat –kilometre is expected to increase by 4%. Destinations likely to be discontinued are [...], Brno, Cologne/Bonn, [...], Marseille, Munich, [...], Thessaloniki, [...]. Long-haul flights to North America have been already discontinued. The aircraft fleet shall be reduced by over 30%, the number of flights by 40%, the fleet block-hours shall be reduced by 34% and available seat-kilometres by 29%. Consequently the seat-load factor shall improve from 66% to [68 to 70] %. The fleet structure shall be simplified by reduction of aircraft types leading to lower maintenance and purchasing costs. Network resizing is expected to cost CZK 300 million and contribute to the revenues with CZK 500 million by the end of 2012.
 - *Revenue Optimisation.* Czech Airlines introduced at the end of 2009 a new revenue management system to optimise fare-setting and availability, aiming at an increase in revenue per available seat-kilometre by [2.5 to 3.5] % in 2011. Further revenue increase is predicted in connection with the expected rise of sales through Czech Airlines own website. [18 to 20] % of tickets shall be sold online by 2012, against 8% in 2009. This shall be accompanied with revenues from sales of associated own products, such as second baggage fees, premium seat assignment fees and on-board sales, as well as products from third parties, such as hotels, car rentals and travel insurances. Revenue management is expected to contribute to the profits by CZK 550 million by the end of 2012.
 - *Cost Reduction Initiatives.* Czech Airlines aims at reduction of the number of pilots and cabin crew to the regulated minimum, at reduction of catering costs in economy class, in-flight entertainment, cost of irregularities and fuel consumption. Moreover, the administrative headcount, as well as the rental, IT and telecommunication costs shall be reduced. Finally the representation offices abroad and in the Czech Republic shall be downsized. Cost reduction initiatives are expected to cost CZK 300 million and contribute to the revenues with CZK 700 million by the end of 2012.
40. As concerns the structural measures relating to the subsidiaries within the holding, a competitive pricing of intra-group services should be achieved in order to stimulate the profit making of all subsidiaries and their orientation towards external customers:
 - The maintenance, repair and overhaul department shall be split in two units. One attending to landing gear maintenance of B737, is aimed to be sold, and

the other engaged in heavy and light maintenance shall be spun off into a separate subsidiary of Czech Aeroholding, offering more services to third parties with the view of its future sale;

- Similarly, Czech Airlines Handling shall be spun off into separate subsidiary of Czech Aeroholding and further possibly joint with the handling activities of Prague Airport in order to achieve economies of scale;
- ČSA Services shall also become a subsidiary of Czech Aeroholding seeking to expand third party business;
- Czech Airlines will discontinue the activities of *Holidays Czech Airlines*.

41. In the restructuring plan the following market developments are expected:

- From 2010 onwards, the impact of the downturn on the global airline industry is expected to recede. Both passenger traffic and yield are likely to recover from the decline experienced in 2008 and 2009. International Air Transport Association (IATA) expects the year to year growth of passenger volume between Central and Eastern Europe on the one hand and Western Europe on the other to be 4.9% in 2010, 7.6% in 2011 and 8.0% in 2012. Year to year growth of passenger volume within EU is expected to be 6.5% in 2010, 9.0% in 2011 and 10.2% in 2012.
- Having suffered in the downturn, the Czech airline market is expected to return to the path of growth in 2011. It is likely that growth will be driven by development of place-to-place traffic with continued expansion of low cost carriers. The experience of neighbouring countries suggests that low cost carriers may significantly increase their market share as place-to-place routes become large enough to efficiently fill deployed capacities with non-transfer passengers – a trend which is additionally supported by a so-called “boost effect” of additional traffic generation via introduction of low-fare flight options. Typically, low cost carriers claim shares of most important profit pools of the market (largest place-to-place routes) while also putting increased pressure on revenues of incumbents (including Czech Airlines) by offering cheap fares in line with their low-cost product. The expected growth of low cost carriers in the Czech Republic is supported by the example of Poland where the proportion of low cost carriers on total capacity is above 50% in summer and around 49% in winter while in the Czech Republic such proportion is only around 35% in summer and 22% in winter.
- Simultaneously, the Czech market is expected to attract entries by new full service carriers. In 2010, Emirates Airline is likely to start operations from Prague to its Dubai hub. Emirates – an airline benefiting from unique cost positioning, very advantageous hub and the support of local government – is expected to claim significant share especially on Middle East, South Asia and Pacific Rim routes.
- The expected expansion of competitors, with inherent advantages in terms of cost and geography, means that Czech Airlines passenger demand growth is unlikely to be in line with the market. Czech Airlines passenger volume growth is expected to be [3 to 10] % in 2010, [0% to -10] % in 2011 and [3%

to -11] % in 2012. Yield is expected to deteriorate by [-1% to -5] % in 2010, [-7 to -10] % in 2011 and [-4 to -9] % in 2012.

42. As a consequence of the restructuring, Czech Airlines expect the following development of return on capital employed (ROCE):

Table 4: Expected return on capital employed

ROCE	Dec 2010	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015
best scenario	[-2.2 to -1.8] %	[1.8 to 2.2] %	[3.0 to 3.4] %	[2.8 to 3.1] %	[2.0 to 2.4] %	[2.3 to 2.8] %
intermediate scenario	[-17 to -16.0] %	[-7 to -6] %	[-3 to -2] %	[1.5 to 2.0] %	[2.9 to 3.4] %	[3.8 to 4.4] %
worst scenario	[-16.8 to -15.8] %	[-13 to -12] %	[-9.8 to -8.9] %	[-4.3 to -3.8] %	[-0.09 to 0.5] %	[1.9 to 2.3] %

The Czech authorities take the best scenario as a realistic prediction and argue that the ROCE achieved at the end of 2012 of [3,0 to 3,4] % is to be considered as acceptable, because, firstly, it is higher than gross yield for five years bonds. Secondly, according to the Czech authorities, ROCE higher than 2.0 % seems to be above industry standard, as typical full service carriers' ROCE levels reached in the years before the crisis (2004-2007) from -14% to +11% (and the industry leaders in Europe (Lufthansa, Air France-KLM and British Airways) achieve ROCE of 2-6% in medium term, while Czech Airlines peer group (AF-KLM, AA, Finnair, SAS, BA, Croatia Airlines, LH) reached and average ROCE of 1.7% in past years (2003-2009).

43. The following assumptions are made for the various scenarios.

Best scenario:

- Fuel market price 721 \$/mT,
- Fixed exchange rates: 18.0 CZK/USD, 26.0 CZK/EUR,
- Inflation rate of 2%,
- Yield [2,3 to 2,4], load factor [70,0 to 73] %,
- Average yearly market growth at 5-10% (dependent on year and region),
- Implementation of all proposed initiatives in full scale and on time.

Intermediate scenario:

- Lower growth in demand between 2010-2013,
- Implementation of most network related initiatives already in 2010 negatively impacting revenue between 2010-2013 but enabling accelerated growth in 2014 and 2015 (average PAX revenue +1/1.5% in 2014/2015),
- Revenue management system not fully optimised in 2010 decreasing average revenue per PAX (best scenario -4%).

Worst scenario:

- Increase in fuel prices (best scenario +5%),
- Increase in CZK/USD exchange rate (best scenario +3%) and decrease in CZK/EUR exchange rate (best scenario -3%),
- Reduction in yields (best scenario -5%/-2% in 2010/2011),
- Natural disaster with flight cancellation (5 days in high season 2012),
- One season delay in the restructuring implementation,

- Lower benefits from the cost and revenue managements initiatives,
- Strikes (5 days in high-season in 2011),
 - Reduced costs, about 50% of revenue loss,
 - Compensation for 15% PAX - 250EUR/PAX.

3.3. Compensatory measures

44. The Czech authorities indicated that due to its relatively small size and the strong competition it faces on its main markets, the presence of Czech Airlines has a positive, stimulating effect on competition. Therefore, the measures under examination will have only limited effects on competition on those markets. In addition, the Czech authorities observed that the company's own contribution to the restructuring plan is also particularly high. Consequently, the Czech authorities argue that there is only a limited need for compensatory measures in this case. According to the Czech authorities, in light of the structure of the markets concerned and their conditions of competition, to impose further compensatory measures on Czech Airlines might in certain circumstances even have an adverse effect on competition, in that they could lead to a deterioration of the market structure.
45. The Czech Airlines stated that it has already taken a number of measures which will limit the effect of state aid on the competitive environment. These include:
 - reduction of the offered capacity (in terms of ASK) by more than 30% between 2009 and 2015 by reducing frequency on European routes and termination of long-haul routes to North America;
 - head count reduction from the average of 3 600 in 2009 to 3 200 in early 2010;
 - reduction of the number of aircrafts and fleet by more than 27%; and
 - reduction of the number of destinations by more than 30%.
46. The Czech authorities are also of the opinion that any further compensatory measures would jeopardize the restoration of the company's long-term viability. As regards future perspectives of Czech Airlines' development after the restructuring process is completed, the Czech Authorities presume that the company will grow at the rate of average growth in the air transportation industry in Europe at the most.

3.4. Own contribution

47. The Czech authorities notified own contribution measures in the amount of CZK [...] million to contribute to the financing of the restructuring costs of CZK [...] million over the duration of the restructuring plan.
48. First, the Czech authorities proposed a sale of assets not essential to the survival of Czech Airlines. Indeed, according to the restructuring plan and information submitted in the later correspondence by the Czech authorities, the following assets and business departments were sold or should be sold :
 - *Sale of APC building and adjoining land.* The Czech authorities informed the Commission that the sale of APC building was carried out in December 2009

for CZK 607 million. The sale of adjoining land was done in May 2010 and the revenues from the sale amounted to CZK 138 million.

- *Sale of building Hangar F and a land under it as well as adjoining land.* The sale of Hangar F and land under it was carried out for CZK 816 million. The sale of adjoining land was likewise carried out for an amount of CZK 123 million. These transactions were performed on the basis of a sale agreement between Czech Airlines and Prague Airport of 13 May 2010. The Czech authorities underlined that as the sale was carried out in line with an independent market evaluation by YBN Consult from 10 May 2010 for the same price, this transaction was done on market terms.
- *Sale of duty-free operations.* This sale was carried out in February 2010 for CZK 764 million.
- *Sale of maintenance section (landing gear unit).* The Czech authorities alleged that this sale was to be performed in 2010 for an estimated price of CZK [...] million. The Commission asked clarification on whether this measure was carried out and whether the sale price was achieved. This submission of information from Czech authorities on this issue is still pending.
- *Exchange of slots at Heathrow airport against financial compensation.* A contract between Czech airlines and British Airways Plc for exchange of slots against financial compensation for the winter schedule of 2010-2011 and the summer schedule of 2011 was signed on 7 July 2010 for GBP [...] million. Czech airlines received a financial compensation of GBP [...] million on 12 November 2010 and of GBP [...] million on 2 December 2010. The Czech authorities noted that given an average exchange rate: 1 GBP – CZK 30.27079, the revenues from this transaction amount to CZK [...] million.
- *Sale of Boeing aircrafts.* The restructuring plan envisages phasing out of Boeing aircrafts. In this regard, the plan envisages a sale of 5 Boeings B737-400 aircrafts, 5 Boeings B737-500 aircrafts and return the remaining Boeing aircrafts under an operational leasing back to the leaser in 2011-2012. The Czech Airlines originally envisaged that the sale price for 10 Boeings would amount to CZK 1.1 – 1.2 billion but later included in the restructuring plan only CZK 1.1 billion of own contribution, stressing that this is a conservative figure. Accordingly, on 16 July 2010, Czech Airlines concluded a contract with BLF Limited (belonging to UTair Aviation JSC) for a sale of 5 Boeing B737-400 (MSN 28473, MSN 28474, MSN 28476, MSN 28477 and MSN 28478) for approximately USD [...] million. The sale price was payable according to a delivery schedule of the airplanes from August 2010 – November 2010. The actual delivery took place from 2 September 2010 until 29 November 2010 for USD [...] million. Additionally, as regards the sale of 5 Boeings B737-500, the Czech authorities estimated revenue of approximately USD 35 million, in the line of an evaluation of Aircraft Value Analysis Company. To date, the Czech authorities informed the Commission, two of these aircrafts (MSN 28470 and MSN 28469) have been sold to Mauritanian Airlines International for USD [...] under a contract of 19 November 2010. One of the aircraft has been delivered and the price fully paid for. The other, according to the information at the Commission disposal, has not been

delivered and fully paid for. Moreover, the Czech authorities noted that as regards the three remaining aircrafts, negotiations are still underway with potential buyers. Thus, on this basis, the revenues from sale of the aircrafts amounting to approximately CZK 1.23 billion so far exceeds the projections of the Czech authorities of CZK 1.1 billion.

49. Second, the Czech authorities notified a cumulative cash gain of 2010 and 2012, partially used to cover the interests payments on Osinek loan and Airbus delivery in 2011 as an own contribution. The Commission asked additional information on this measure and the submission of the Czech authorities is still pending.
50. Third, additionally to the sale of assets, the Czech authorities mentioned in the notification that two bank loans are to be considered as own contribution to the restructuring: a bank loan from [...] of CZK [...] of December 2009 and a bank loan of EUR [...] (approximately CZK [...] million) from [...]. No further information has been submitted to the Commission and these two loans were not included in the restructuring plan as an own contribution in the subsequent submissions.
51. On the basis of the above, the Commission at this stage observes that the proposed own contribution measures which were already carried out might amount to approximately CZK 4262 million²¹.

4. ASSESSMENT OF THE MEASURES

4.1. Existence of aid within the meaning of Article 107(1) of the TFEU

52. By virtue of Article 107(1) Treaty on the Functioning of the European Union (hereinafter "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 the Member States, be incompatible with the internal market.
53. In its *Decision (2010)987fin of 24.2.2010 in the case State aid NN 1/2010 (ex CP 371/2009) – Czech Republic ČSA – Czech Airlines a.s. – possible State aid implications of a loan provided by Osinek a.s.* the Commission expressed in detail its view that it cannot exclude that the Osinek loan amounts to State aid within the meaning of Article 107(1) TFEU. The question of whether and to which extent the Osinek loan constitutes State aid is dealt by in the procedure SA.29864

²¹ Taking into consideration for the calculation an exchange rate: 1 USD – 17.682 CZK, at 30 January 2011. The amount of the own contribution was calculated as follows:

Sale of asset	mio CZK
APC building	607
Adjoining land of APC building	138
Hangar F and a land under it	816
Adjoining land of hangar F	123
Duty-free operations	764
Maintenance section (landing gear unit)	[...]
Slots at Heathrow	[...]
Boeing aircrafts	[...]
Total	4262

(ex C 6/2010). Therefore, the Commission refers to the above mentioned decision for more details on the Osinek loan. In the following only the existence of State aid in respect to the debt-to-equity swap and a potential aid for aircraft purchase in 2011 will be discussed.

4.1.1. State resources and imputability

54. The concept of State aid applies to any advantage granted directly or indirectly, financed out of State resources, granted by the State itself or by any intermediary body acting by virtue of powers conferred on it.
55. It has to be established if the measures listed above can be regarded as involving State resources.
56. The Czech Republic decided in two Government Resolutions on the debt-to-equity swap of the Osinek loan, including its previous de-collateralisation. Meanwhile, the Osinek loan has been transferred on the Ministry of Finance, thus at the moment of the debt-to-equity swap the creditor of the Osinek loan was directly the State.
57. The Commission notes that through the de-collateralisation, the Czech State has foregone its proprietary rights to the collaterals in case of default in reimbursement of the Osinek loan. Through the debt-to-equity swap, the State has foregone interest payments as well as the reimbursement of the loan. Consequently, the Czech State directly transferred state resources to Czech Airlines.
58. As concerns the envisaged aid for aircraft purchase, it is foreseen by the Czech authorities in their notification and it shall be granted through Export Guarantee and Insurance Company (EGAP). EGAP is 100% state owned, through Ministry of Finance (40 %) Ministry of Economics and Trade (36 %), Ministry of Foreign Affairs (12 %) and Ministry of Agriculture (12 %) which are directly financed from the state budget. By the notified potential aid for aircraft purchase, the Czech authorities will thus provide a guarantee to a company in difficulties (see chapter 4.3.2 below), granted through State resources and imputable to the State.

4.1.2. Economic advantage

59. In the present case, the Commission has to assess whether the measures listed above confer an economic advantage on Czech Airlines taking into account its financial situation. This involves verifying whether the recipient undertaking would have obtained such financing from a private investor under normal market conditions. According to this principle, capital put at the disposal of a company by the State, directly or indirectly, in circumstances which correspond to the normal conditions of the market, should not be qualified as State aid²².
60. At the moment of the debt-to-equity swap and prior de-collateralisation of the loan, the Czech authorities considered Czech Airlines to be a firm in difficulties;

²² Communication of the Commission to the Member States: application of Articles 92 and 93 of the EEC Treaty and of Article 5 of the directive 80/723/CEE of the Commission to public undertakings in the manufacturing sector, OJ C 307 of 13.11.1993, p. 3, paragraph 11. This communication deals with the manufacturing sector, but is applicable to the other economic sectors. Cf. also Case T-16/96, Cityflyer, [1998] ECR II-757, para. 51.

that is unable to stem losses which without outside intervention by the public authorities would almost certainly condemn it to going out of business. In such circumstances, a private profit oriented investor would neither give up its collaterals, nor capitalise its loan, as both the transactions would considerably increase his exposure to risk and lower the chances for loan reimbursement. In addition, there is no evidence that the State was compensated for this increase in risk by proportional increased expectations of return on the investment. Moreover, none of the minority investors, who were all offered to increase their participation in Czech Airlines, agreed to such an investment. Czech Airlines therefore received the capital increase under conditions that would not be available on the market. Consequently, the debt-to-equity swap, including the de-collateralisation constitutes an economic advantage.

61. As concerns the aid for aircraft purchase, it is unlikely that a reasonable market economy investor would guarantee a loan of an undertaking in difficulties. Also the Czech authorities consider in their notification the guarantee as containing State aid element. It follows that this measure, too, confers an economic advantage to Czech Airlines. The Commission notes that a State aid element of a state guarantee to a company in difficulties can amount up to the nominal amount of the guaranteed loan.

4.1.3. Selectivity

62. Article 107(1) TFEU requires that a measure, in order to be defined as State aid, favours "*certain undertakings or the production of certain goods*". In the case at issue, the Commission notes that the measures in question have been granted to Czech Airlines only. Thus they are selective within the meaning of Article 107(1) TFEU.

4.1.4. Distortion of competition and affectation of trade

63. Moreover, the measures at stake affect trade between Member States and distort or threaten to distort competition in the internal market. Thanks to them Czech Airlines are relieved from the costs that they would otherwise have to bear in its day-to-day operations. Indeed, Czech Airlines can continue operating and does not have to face the consequences normally deriving from its poor financial results over a long time laps. Czech Airlines is moreover in competition with other European Union airlines, in particular since the entry into force of the third stage of liberalisation of air transport ("third package") on 1 January 1993.

4.1.5. Conclusion

64. On the basis of the above, the Commission considers at this stage that the measures identified above amount to State aid within the meaning of Article 107(1) TFEU. This appreciation is confirmed by the Czech authorities.

4.2. Legality of the notified measures

65. Article 108(3) TFEU indicates that a Member State shall not put an aid measure into effect before the Commission has taken a decision authorising this measure. The Commission observes that the Czech authorities implemented on 30 April 2009 the Osinek loan and as of 30 June 2010 the debt-to-equity swap. The Commission thus regrets that the Czech authorities did not comply with the stand-still obligation. Consequently, these measures constitute unlawful aid. As regards

the possible aid to the purchase of new aircraft, it has not yet been put into effect as of today and therefore the standstill obligation is currently complied with.

4.3. Compatibility with the internal market

4.3.1. Legal basis for appraisal

66. Article 107(3)(c) TFEU provides that State aid can be authorised where it is granted to promote the development of certain economic sectors and where this aid does not adversely affect trading conditions to an extent contrary to the common interest.
67. In this respect, the applicable Union framework for deciding on compatibility is the Community Guidelines on State aid for rescuing and restructuring firms in difficulty of 2004²³ (hereinafter "the Rescue and Restructuring Guidelines"). The provisions of point 38 of the 1994 Aviation guidelines²⁴ also have to be met.
68. The Commission can authorise a rescue and restructuring aid as compatible with the internal market pursuant to Article 107(3)(c) TFEU if it complies with the criteria of the Rescue and Restructuring Guidelines which set out the rules as to the eligibility of the firm for the aid and the conditions for authorising rescue as well as restructuring aid.
69. The notified restructuring aid must comply with the conditions of
 - eligibility,
 - long-term viability of the restructuring plan,
 - avoidance of undue distortion of competition, including the compensatory measures, and
 - own contribution.
70. The Commission in this regard observes that only companies in difficulty in the meaning of the Rescue and Restructuring Guidelines are eligible for rescue or restructuring aid. The notified State aid to a company in difficulty cannot be found compatible with the internal market under any other legal basis.

4.3.2. Eligibility for rescue and restructuring aid

Company in difficulties

71. To be eligible for rescue and restructuring aid, it must be demonstrated that Czech Airlines is a company in difficulty within the meaning of the Rescue and Restructuring Guidelines.
72. Point 9 of the Rescue and Restructuring Guidelines states that "*the Commission regards a firm as being in difficulty when it is unable, whether through its own resources or with the funds it is able to obtain from its owners/shareholders or creditors, to stem losses which without outside intervention by the public authorities, will almost certainly condemn it to going out of business in the short or medium term*".

²³ Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty, OJ C 244, 1.10.2004, p.2., and Commission Communication concerning the prolongation of the Community Guidelines on State aid for Rescuing and Restructuring Firms in Difficulty, OJ C 156, 9.7.2009, p. 3.

²⁴ Application of articles 92 and 93 of the EC Treaty and article 61 of the EEA Agreement to State aids in the aviation sector, 94/C 350/07, OJ C 350 of 10.12.1994, p. 5.

73. Subsequently in point 10 the Rescue and Restructuring Guidelines set out a presumption that *"a firm is, in principle and irrespective of its size, regarded as being in difficulty for the purposes of these Guidelines in the following circumstances:*
(a) in the case of a limited liability company, where more than half of its registered capital has disappeared and more than one quarter of that capital has been lost over the preceding 12 months;
(...)
(c) whatever the type of company concerned, where it fulfils the criteria under its domestic law for being the subject of collective insolvency proceedings".
74. Point 11 of the Rescue and Restructuring Guidelines also provides that *"even when none of the circumstances set out in point 10 are present, a firm may still be considered to be in difficulties, in particular where the usual signs of a firm being in difficulty are present, such as increasing losses, diminishing turnover, growing stock inventories, excess capacity, declining cash flow, mounting debt, rising interest charges and falling or nil net asset value."*
75. As point 10(a) of the Rescue and Restructuring Guidelines is concerned, the above tables show that in June 2009 Czech Airlines own capital was still CZK [...] billion, that is more than the registered capital amounting to CZK 2.74 billion. The registered capital was thus at that moment still preserved. However, the own capital dropped quickly to CZK -2.35 billion at the end of 2009. At that moment more than [50] % of the registered capital was lost over the preceding 6 months. Consequently, the Commission considers at this stage that according to the point 10(a) of the Rescue and Restructuring Guidelines, Czech Airlines became a firm in difficulty at the latest at some moment in the second half of 2009.
76. As concerns point 10(c) of the Rescue and Restructuring Guidelines, according to the Czech authorities, the company did not fulfil the criteria under its domestic law for being subject of collective insolvency proceedings. However, the Czech authorities claim that, in light of the developments described above, Czech Airlines can be considered as a firm in difficulties in the meaning of the Rescue and Restructuring Guidelines starting from August 2009.
77. As concerns point 11 of the Rescue and Restructuring Guidelines, it cannot be excluded at this stage that Czech Airlines was in difficulties already before the second half of 2009 (for financial indicators in this respect, see points 20-30 above). This is mainly relevant for the Osinek loan. For the purpose of the assessment of Osinek loan, the fact whether Czech Airlines was in difficulties according to the Rescue and Restructuring Guidelines when the loan was granted, is subject of the above mentioned formal investigation procedure SA.29864 (ex-C 6/2010). In the framework of the underlying notification the Czech authorities submitted further information.

Business group

78. Point 13 of the Rescue and Restructuring Guidelines stipulates that a *"firm belonging to or being taken over by a larger business group is not normally eligible for rescue or restructuring aid, except where it can be demonstrated that the firm's difficulties are intrinsic and are not the result of an arbitrary allocation of costs within the group, and that the difficulties are too serious to be dealt with by the group itself."*

79. The government of the Czech Republic ordered on 24 November 2010 in the Government Resolution 848 to establish a public limited company Czech Aeroholding and to transfer to it Czech Airlines as well as Prague Airport. Given that Czech Airlines, according to the present Commission assessment, entered into difficulties before the merger, it appears at this stage that its difficulties are intrinsic in the sense of point 13 of the Rescue and Restructuring Guidelines.
80. However, under the same point, the Czech authorities should also demonstrate that the difficulties are too serious to be dealt with by the group itself. In this respect, first, the Czech authorities are invited to comment whether - given the current shareholding structure of the group - it is possible under the Czech law that Czech Airport (financially) contributes to the restructuring process of Czech Airlines and its subsidiaries (i.e. the remaining companies within the group). Second, the Czech authorities should in this respect comment whether the business transactions between the Czech Airlines and Prague Airport are, as of the date of the implementation of the merger, taking place at market terms (arm's length) which would exclude the transfer of possible State aid from a beneficiary of rescue or restructuring aid to another entity within Czech Aeroholding. Third, the Czech authorities are likewise asked to submit the financial projections of Prague airport (a balance sheet, a profit and loss account and a cash flow statement for 2008, 2009 and partial results for 2010).

One time, last time principle

81. Finally, the aid must respect the 'one time, last time' principle of point 72 and 73 of the Rescue and Restructuring Guidelines which lays down that if the company concerned has already received rescue or restructuring aid in the past and if less than 10 years have elapsed since the restructuring period came to an end, the Commission will normally not allow further restructuring aid. The only exception potentially relevant to this case is permitted under point 72(a) of the Guidelines, *"where restructuring aid follows the granting of rescue aid as part of single restructuring operation"*.
82. At this stage, the Commission maintains its doubts on the state aid character of the Osinek loan which is subject to a procedure SA.29864. However, it notes that if it can be determined that Osinek loan constituted State aid to a company in difficulties - at the time the loan was granted - in the sense of the Rescue and Restructuring Guidelines, it cannot be excluded that the Commission can consider it as part of a single restructuring operation together with the two other notified measures pursuant to point 73(a) of the Rescue and Restructuring Guidelines. On the other hand, if the Commission concludes in the framework of the procedure SA.29864 that the Osinek loan did not constitute State aid to a company in difficulty, this point is irrelevant for the application of the "one time, last time" principle as the latter is triggered only by rescue or restructuring aid.
83. It shall, however, be reminded that if Osinek loan is to be found to constitute incompatible State aid, no further aid can be approved by the Commission unless the incompatible aid was first reimbursed.²⁵

²⁵ See third paragraph of chapter 4 of this decision.

84. In conclusion, the Commission at this stage considers that Czech Airlines was a company in difficulties at latest at some point in second half of 2009 according to point 10(a) of the Guidelines. However, for the Commission is unable to conclude on the eligibility of the company for aid under the Rescue and Restructuring Guidelines pending the information necessary for the assessment of point 13 of the Guidelines. The Commission hereby also recalls the reasoning above regarding the eligibility pursuant to point 72 and following of the Rescue and Restructuring Guidelines.

4.3.3. Restoration of long term viability

85. The second condition (as set out in point 35 of the Rescue and Restructuring Guidelines) to be complied with is that 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. Restructuring aid must therefore be linked to a viable restructuring plan to which the Member State concerned commits itself. The plan must be submitted in all relevant detail to the Commission and include, in particular, a market survey. The improvement in viability must derive mainly from internal measures contained in the restructuring plan; it may be based on external factors such as variations in prices and demand over which the company has no great influence, but only if the market assumptions made are generally acknowledged. Restructuring must involve the abandonment of activities which would remain structurally loss-making even after restructuring.”*
86. Pursuant to point 36 of the Rescue and Restructuring Guidelines the plan must describe the circumstances that led to the company's difficulties and take account of the present state and future market prospects with best-case, worst-case and intermediate scenarios.
87. The point 37 of the Rescue and Restructuring Guidelines goes on to provide that *“The plan must provide for a turnaround that will enable the company, after completing its restructuring, to cover all its costs including depreciation and financial charges. The expected return on capital must be enough to enable the restructured firm to compete in the marketplace on its own merits.”*
88. The restructuring plan, assuming the best case scenario presented being the most likely to happen, covers the period from the second half of 2009 until the expected return to viability at the end of 2012. If this period could be regarded as realistic, and in the view of the extent of the restructuring measures foreseen, the restructuring period could be considered as short as possible. It has to be however noted that should the Commission accept that Osinek loan constitutes rescue or restructuring aid and can thus fall under the single restructuring period, the restructuring period will be prolonged accordingly.
89. In the view of the restructuring measures, the Commission sees that the expected improvement in viability shall derive mainly from internal measures, in particular from network optimisation and fleet rightsizing, revenue optimisation and fleet reduction. However, the underlying assumptions on the external factors play also an important role in the return to viability. Having doubts about whether these assumptions are realistic or generally acknowledged, the Commission invites interested parties to comment on these aspects.

90. Although the restructuring plan foresees discontinuation of the less profitable routes, it is not clear from the submitted documentation whether all activities which would remain structurally loss making even after restructuring shall be abandoned. The Commission invites therefore the Czech authorities to submit this information.
91. The Commission notes that the restructuring plan, as summarised in chapter 3.2 above, describes the circumstances that led to the company's difficulties, it takes into account present and future prospects on the main market of the Czech Airlines, that is in scheduled passenger air transport, it presents scenarios based on best-, worst- and intermediate-case assumptions, as well as Czech Airlines' strengths and weaknesses. The Commission thus notes that the restructuring plan deals all formal aspects required by the point 36 of the Rescue and Restructuring Guidelines.
92. Nevertheless, at this stage the Commission has doubts on whether the presented best scenario is the most realistic one and whether long term viability can be achieved at the end of 2012 and consequently on what is the most likely duration of the restructuring period and whether it is as short as possible, account taken of the size of the beneficiary, its difficulties and the industry in which it operates. The Commission has currently doubts on whether the expected improvement in the financial situation of Czech Airlines is realistic and if yes, whether it can be considered as achieving long term viability. While the Commission notes that the expected financial results (under the best scenario) seem to be in line with the average performance of the full service carriers industry, it has doubts on whether it will indeed lead to long term viability. Moreover, it is doubtful whether Czech Airlines will be able to finance from its own resources or from commercial loans and possible commercial guarantees the purchase of seven aircrafts contracted for the years 2013 and 2014.
93. In view of the above, the Commission invites the Czech authorities to provide additional information which would allow it to determine whether (i) long term viability can be achieved at the end of 2012; (ii) the duration of the restructuring period would not be longer and whether this period will be still as short as possible; (iii) Czech Airlines will be able to finance with its own resources or with commercial loans/commercial guarantees the purchase of seven aircrafts.

4.3.4. *Avoidance of undue distortions of competition*

94. Pursuant to points 38-42 of the Rescue and Restructuring Guidelines, measures must be taken to mitigate any adverse effects of the aid on competitors as far as possible. The aid shall not unduly distort competition. This usually means a limitation of the presence which the company can enjoy on its markets at the end of the restructuring period. The compulsory limitation or reduction of the company's presence on the relevant market represents a compensatory factor in favour of its competitors.
95. The compensatory measures should be in proportion to the distortive effects of the aid and to the relative importance of the firm on its market or markets. Moreover, according to point 7 of the Rescue and Restructuring Guidelines the Commission "*will request compensatory measures which minimise the effect on competitors*".

96. The Commission notes that Czech Airlines is a relatively small company, facing strong competition both from full service companies and low cost companies. Its market shares are in general relatively low on the majority of the destinations it operates. However, there are a number of destinations where the company does not face significant competition or it is the only one operating on the route. Consequently, the Commission considers at this stage that compensatory measures are necessary and they should be appropriate to mitigate the adverse effects of the State aid on the markets.
97. However, the Commission has doubts at this stage whether the compensatory measures proposed by the company are not merely closure of loss-making activities which would at any rate be necessary in order to achieve viability. If this is the case, such measures would not be considered as compensatory according to point 40 of the Rescue and Restructuring Guidelines. At the same time, some of the divestments and reduction of profit-making activities included in the restructuring plan may be considered as compensatory measures, in particular, where business units proposed to be sold within the restructuring plan are profit making.
98. Moreover, only compensatory measures taking place within the restructuring period can be accepted. In this regard it appears that the discontinuation of the Toronto and NY JFK flights fall outside the currently proposed duration of the restructuring plan, i.e. second half of 2009 until 2012.
99. In view of the above, the Commission invites the Czech authorities to provide additional information which would allow it to determine whether the proposed compensatory measures are indeed going beyond what is necessary in order to achieve long term viability. In addition, the Commission invites the Czech authorities to comment there are any other measures undertaken in the context of the restructuring plan which constitute adequate compensatory measures.

4.3.5. *Aid must be limited to the minimum, own contribution*

Aid must be limited to the minimum

100. Point 43 of the Rescue and Restructuring Guidelines provides that the “*amount and intensity of the aid must be limited to the strict minimum of the restructuring costs necessary to enable restructuring to be undertaken in the light of the existing financial resources of the company, its shareholders or the business group to which it belongs. Such assessment will take account of any rescue aid granted beforehand*”.
101. It cannot be excluded that following the merger, changes to the restructuring plan of the Czech airlines will be introduced, in order to exploit the existing synergies and economies of scale and scope.
102. At this stage, the Commission notes that it misses the information to assess, whether in the new group structure Prague Airport will be able to contribute to the restructuring of the Czech Airlines. Thus, on the basis of the information at its disposal and not excluding the changes to the restructuring plan in this regard, the Commission is not in a position to express its view whether the conditions laid down in the first sentence of point 43 are respected. The Commission therefore asks the Czech authorities to submit detailed information in this regard.

Level of own contribution

103. In relation to the level of own contribution point 43 of the Rescue and Restructuring Guidelines provides that *“Aid beneficiaries will be expected to make a significant contribution to the restructuring plan from their own resources, including the sale of assets that are not essential to the firm's survival, or from external financing at market conditions. Such contribution is a sign that the markets believe in the feasibility of the return to viability. Such contribution must be real, i.e., actual, excluding all future expected profits such as cash flow, and must be as high as possible.”* The Rescue and Restructuring Guidelines then indicate what level of own contribution would normally be considered as appropriate; for a company the size of Czech Airlines this rate would be 50%.
104. The Commission bases its current assessment on the restructuring costs on the basis of the latest information at its disposal. Accordingly, the restructuring costs amount to CZK 8.393 million. Hence, the Commission finds that current own contribution ascertained (outside the cumulative capital gain mentioned in point 49) – relative to measures notified and carried out amounts to CZK 4262 million – would be more than 50 % of the restructuring costs.
105. The Commission notes that the repayment of the loan of [...] is included in the restructuring costs in the amount of [...] million. Consequently, the Czech authorities are asked to specify whether the loan of [...] was concluded and if so, submit the loan agreement and, if applicable, update the restructuring plan accordingly. Moreover, the Czech authorities are asked to submit the loan agreement with Komerční banka.
106. However, as regards the contribution proposed but not implemented yet, in particular, sale of maintenance section (landing gear unit) and the remaining sale of 3 Boeing aircrafts, the Commission has at this stage doubt whether this own contribution can be considered real, i.e. whether the proposed level of the contribution is likely to be achieved.
107. In addition, the Commission doubts that the cumulative cash gain can be considered an own contribution in the meaning of point 43 of the Rescue and Restructuring Guidelines. It appears that this item of own contribution can be assimilated to "all future expected profits such as cash flow" and thus would not appear to qualify as a real contribution to the restructuring.
108. However, the Commission observes that following the merger, the restructuring costs might alter. Thus, it reserves the right to assess this compatibility condition in the light of the information which it expects to receive from the Czech authorities in this regard.
109. The Commission likewise underlines that under point 45 of the Rescue and Restructuring Guidelines, *"the amount of aid or the form in which it is granted must be such as to avoid providing the company with surplus cash which could be used for aggressive, market distorting activities not linked to the restructuring process."*
110. The Commission lacks information on this point. Hence, the Commission at this stage cannot express its view whether point 45 of the Rescue and Restructuring Guidelines is complied with. Therefore, the Commission invites the Czech authorities to comment whether this provision is respected and supply the appropriate information.

4.3.6. *Conclusion*

111. At this stage of its investigation, the Commission has doubts about the compatibility of the notified State aid with the internal market. It would like to invite all interested parties to submit their comments on the State aid character and the compatibility of the notified measures, especially concerning the issues on which the Commission expressed its particular doubts throughout the chapter 4.3 of this decision.

5. DECISION

In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 108(2) of the TFEU, requests the Czech Republic to submit its comments and to provide all such information as may help to assess the compatibility with State aid rules of the measures at stake, 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.

The Commission wishes to remind the Czech Republic that Article 108(3) of the TFEU has suspensive 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 reminds the Czech Republic in particular that if Osinek loan or any subsequent measure will be found to constitute incompatible State aid, no further aid can be approved by the Commission unless the unlawful and incompatible aid was first reimbursed.²⁶

The Commission warns the Czech Republic 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 that 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 that 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 the letter.

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
B-1049 Brussels

Fax No: +0032 (0) 2 2961242

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President of the Commission

²⁶ Deggendorf principle, see Joined cases T-244/93 and T-486/93, *TWD/Commission*, [1995] ECR II-2265; Case C-355/93P, *TWD/Commission*, [1997] ECR I-2549.