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Subject: State aid SA.35888 (2013/C) (2013/NN) – Cyprus – Rescue aid for Cyprus Airways (Public) Ltd

Madam,

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.

1. PROCEDURE

1.1. The *ex officio* investigation (SA.34350 (2012/CP))

- (1) In February 2012 the Commission services were informed through the press that the Cypriot government had decided to raise the share capital of Cyprus Airways (Public) Ltd. ('Cyprus Airways') and had approved the participation of the State as the main shareholder in the new capital issue.¹ Furthermore, the Cypriot government appeared to be envisaging a sale of its shares to a (new) strategic investor.

¹ <http://www.bloomberg.com/news/2012-02-08/cabinet-authorizes-sale-of-cyprus-airways-capital-boost-1-.html>

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- (2) Taking into account past state aid measures (see below) and the fact that no measures were notified to the Commission for a state aid assessment, an *ex officio* investigation was initiated on 10 February 2012, in order to obtain more information.
- (3) A first request for information was sent by the Commission services to the Cypriot authorities on 20 February 2012. In their reply of 6 April 2012, the Cypriot authorities provided information about the planned terms of a share capital increase of EUR 45 million by all shareholders, public or private. In addition, the Cypriot authorities explained that they would only participate in the share capital increase if all other shareholders contributed their share under the same terms and conditions and based on a sound business plan. Since the Cypriot State holds 69.62% of the company's shares (see (11) below), its contribution to the share capital increase would be EUR 31.3 million.
- (4) Alternatively, the Cypriot authorities intended to participate to the share capital increase if a new investor would contribute at least the part of the capital increase attributed to the private shareholders.
- (5) No measures had been implemented until that date. Thus, a second letter was sent by the Commission services to the Cypriot authorities on 15 June 2012, asking them to keep the Commission informed about the capital increase and to notify any measure involving state aid.
- (6) Following information about an amendment to the State budget that would allow the Cypriot State to contribute to a capital increase of Cyprus Airways, a third letter was sent by the Commission services to the Cypriot authorities on 23 August 2012, reminding them again to keep the Commission informed and to notify any measures involving state aid. In their reply of 30 August 2012, the Cypriot authorities confirmed that they would keep the Commission informed about any new measures, as previously promised in their letter of 6 April 2012.
- (7) On 4 October 2012, a meeting with representatives of the Cypriot authorities and Cyprus Airways took place in Brussels. In the meeting, the Commission services were informed about the measures undertaken by the State in favour of Cyprus Airways, which will be analysed further.

1.2. The rescue aid notification SA.35888 (2013/NN – ex 2012/N)

- (8) By notification of 13 December 2012 the Cypriot authorities notified to the Commission the planned provision of EUR 73 million of state aid for the rescuing of Cyprus Airways, as a function of a Decision of the Cypriot Council of Ministers of 4 December 2012.
- (9) On 19 December 2012, a letter was sent by the Commission services to the Cypriot authorities, requesting information about the form and date of provision of the rescue aid measure. In their reply of 4 January 2013, the Cypriot authorities provided information about the notified measure and confirmed that part of the measure was already granted. on
- (10) According to Council Regulation (EC) No 659/1999 ('Procedural Regulation'), "*aid notifiable pursuant to Article 2(1) shall not be put into effect before the Commission has taken, or is deemed to have taken, a decision authorising such aid*" ("standstill clause").² Since this obligation was not respected by the Cypriot authorities, they were informed by the Commission services by letter of 10 January

² Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83, 27. 3. 1999, p.4, Article 3.

2013 that the measure would be registered as unlawful aid. As a result, the procedural rules applicable to this case would be those laid down in chapter III of the Procedural Regulation.

2. THE BENEFICIARY

- (11) 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 in the Cypriot Stock Exchange. At the end of 2012, the company was 69.62% owned by the Cypriot State and 30.38% by private investors. Cyprus Airways is the only airline with a major base on the island, at the airport of Larnaca.
- (12) Cyprus Airways operates scheduled air services to 41 destinations and currently has a fleet of 11 aircrafts and has approximately 1,100 employees. It therefore qualifies as a large enterprise.³

3. PAST APPROVED STATE AID MEASURES

3.1. The 2005-2007 rescue and restructuring aid

- (13) In 2005, the Commission approved rescue aid for Cyprus Airways in the form of a State loan of CYP 30 million (EUR 51 million).⁴
- (14) In November 2005, Cypriot authorities notified to the Commission a restructuring plan for Cyprus Airways in order to restore its viability. The restructuring package consisted of (i) a loan of CYP 55 million (EUR 96 million) [of which CYP 45 million (EUR 78 million) were backed by a State guarantee]; (ii) a capital increase of CYP 14 million (EUR 24 million), which involved public and private shareholders on equal terms; (iii) the sale of Cyprus Airways' charter arm, Eurocypria, to the State for CYP 13.4 million (EUR 23.6 million) and (iv) cost cutting measures.
- (15) Following an opening of the formal investigation procedure and an invitation to the Cypriot authorities and third parties to provide their comments,⁵ the Commission approved the restructuring aid as compatible with the common market pursuant to Article 87(3)(c) of the EC Treaty.⁶ Eurocypria was eventually liquidated in 2011.

3.2. The compensation scheme for the Turkish overflight ban

- (16) In 2011, Cyprus Airways received unlawful state aid of EUR 20 million in the form of compensation for losses incurred as a result of the ban imposed by Turkey on Cypriot aircrafts flying through its air space. Eligible losses in this sense include the costs incurred as of the date of accession of Cyprus to the EU (1 May 2004). After notification, the scheme was authorised by the Commission as exceptional occurrence pursuant Article 107(2)(b) of the Treaty on the Functioning of the European Union ('TFEU'), thus allowing for the annual compensation of the damages linked to this ban.⁷ In principle, any airline registered in Cyprus is affected by this ban and is eligible for compensation from the scheme. The scheme

³ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.05.2003, p.36.

⁴ N69/2005, Decision of 3 May 2005, published in OJ C 191, 5.8.2005, p. 4.

⁵ C 10/2006 (ex N 555/2005), Decision published in OJ C 113, 13.5.2006, p.2.

⁶ C 10/2006 (ex N555/05), Decision of 7 March 2007, published in OJ L 49, 22.2.2008, p.25.

⁷ SA.32523 (2011/N), Decision of 27 June 2012, published in OJ C 230, 1.8.2012, p.1.

will have a 10-year duration and the Cypriot authorities undertook the commitment to re-notify the scheme thereafter.

- (17) Cyprus Airways is currently the only eligible beneficiary and the EUR 20 million that it received in 2011 was considered as retroactive compensation for the period 2004-2010. For the year 2011, the compensation was EUR 5 million.

4. GENERAL SITUATION OF THE CYPRIOT ECONOMY AND THE CYPRIOT AIRLINE MARKET

- (18) 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, since there are more flights and traffic to/from Cyprus during the summer period. Due to its geographic location and historical reasons, the most important markets for the company are routes between Cyprus and Greece and between Cyprus and the UK whereas more recently Cyprus Airways has been active in domestic flights in the Greek market. Certain routes to the Middle East have also been traditional markets for Cyprus Airways.
- (19) According to the Cypriot authorities, Cyprus Airways had been implementing the 2007 restructuring plan according to schedule until 2008. However, the subsequent financial crisis has caused difficulties for the two main economies, where Cyprus Airways is active.
- (20) Indeed, Greece has been facing a severe recession since 2009, and a sharp deterioration in its financing conditions. In this context, the euro area Member States and the International Monetary Fund ('IMF') have been providing financial support to Greece. As a result of the recession, the number of passengers travelling between Cyprus and Greece has been reduced.
- (21) The Cypriot economy has been facing difficulties as well, 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. As a result of the recession, the number of passengers travelling from Cyprus has been reduced.
- (22) At the same time, the political unrest in Middle East since 2010 has caused a reduction in traffic on certain routes operated by Cyprus Airways.
- (23) Finally, it appears that Cyprus Airways has been facing strong competition by other airlines, particularly low cost airlines, which have recently entered the Cypriot market, offering flights from Cyprus (Paphos or Larnaca airports) on routes served by Cyprus Airways. It has to be noted that, because of the small size of the island, the two civil airport of Larnaca and Paphos have overlapping "catchment areas", i.e. most travellers from/to Cyprus can easily reach either airport.

5. DESCRIPTION OF THE MEASURES

5.1. Measure 1: The first "in advance" payment of the capital increase

- (24) In the meeting of 4 October 2012, the Commission services were informed about the bad financial condition of Cyprus Airways, which had been cumulating losses and had a negative equity since 2011. A capital increase was thus necessary. A capital increase of EUR 45 million was planned since February 2012 and the trading of the company's stocks in the Cypriot Stock Market had been suspended.

However, until the summer of 2012 it had not been possible to conclude the planned capital increase.

- (25) In order to tackle the critical cash flow situation of the Company, the Cypriot authorities proceeded with a EUR 15 million "in advance" payment of its part (i.e. EUR 31.3 million) of the planned capital increase of EUR 45 million in three tranches: (i) EUR 3 million on 21 September 2012; (ii) EUR 8 million on 26 September 2012; (iii) EUR 4 million in October 2012. This "in advance" payment was not notified to the Commission.
- (26) In November 2012, a new business plan ("turnaround plan") was communicated to the Commission. The plan envisaged the turnaround of the Company in 5 years, based on improved cost and productivity factors, new investments and reshuffling of the Company into a "single-class value airline of option-based services". Overall, the plan required a total capital increase of EUR 105 million and projected marginal profitability already as of the second year of its implementation. The plan was subject to approval by the existing shareholders, who would be participating in the capital increase necessary for its implementation.

5.2. Measure 2: The rescue aid

- (27) On 13 December 2012, the Cypriot authorities notified a rescue aid of EUR 73 million to Cyprus Airways. According to the notification, the amount of EUR 73 million constitutes the net cash flow need of Cyprus Airways until 30 June 2013, i.e. for a period of six months. The rescue aid would be provided in the form of a government loan, which would bear an interest of 1.76% and should be repaid by 30 June 2013.
- (28) On 27 December 2012, a second "in advance" payment of EUR 16.3 million of the planned capital increase of EUR 45 million was disbursed without prior notification. In their reply to the Commission letter of 19 December 2012, the Cypriot authorities explained that this payment was included in the notified rescue aid of EUR 73 million. However, the Commission notes that the Cypriot authorities notified a rescue aid in the form of a loan, whereas the EUR 16.3 million "in advance" payment is a part of a capital increase.
- (29) In spite of the stand-still obligation under Article 108(3) TFEU, the Cypriot authorities have explained that they plan to disburse the remaining amount of the rescue aid in the form of monthly loan advances without waiting for a Commission decision.

5.3. Measure 3: *ex-gratia* compensation

- (30) According to the notification of 13 December 2012, the Cypriot Council of Ministers decided on 4 December 2012 to grant *ex gratia* compensation to the Cyprus Airways personnel, which will be considered redundant in the context of the company's restructuring. According to that decision, the conditions for any *ex gratia* compensation were that (i) it would comply with state aid rules; (ii) the trade unions of the company would accept the restructuring plan (i.e. the turnaround plan) and (iii) it would not exceed 50% of the normal compensation to be paid to redundant personnel by the Cypriot Redundant Personnel Fund ('RPF').

6. POSITION OF THE CYPRIOT AUTHORITIES

- (31) As regards the first "in advance" payment of the capital increase of EUR 15 million, the Cypriot authorities have argued that any majority shareholder would

have made it, in order to safeguard its asset until the finalisation of the new business plan and the conclusion of the capital increase by all shareholders.

- (32) Furthermore, the Cypriot authorities argued that, after the "in advance" payment of EUR 16.3 million on 27 December 2012, they were now anticipating the conclusion of the planned capital increase of EUR 45 million by the *pro rata* participation of the private shareholders with the remaining EUR 13.67 million. The Cypriot authorities submitted a written commitment of the biggest minority private shareholder of Cyprus Airways (representing 4.27 %), who appeared willing to contribute at least his share of any capital increase. No similar commitments have been given so far by any other private shareholder.
- (33) The Cypriot authorities explained that they would intensify their efforts to find a strategic investor, who would be willing to participate in the capital increase, in case existing shareholders are not willing to participate in the capital increase and are not willing to buy the government's shareholding.
- (34) In any event, the Cypriot authorities have explained that, in the context of the notification of rescue aid, they envisage advancing the total amount of the rescue aid loan, in order to keep the company in operation.
- (35) As regards the 2005-2007 rescue and restructuring aid, the Cypriot authorities have recalled that Cyprus Airways received compatible state aid and implemented a restructuring plan approved by the Commission (see recital (15) above). However, the Cypriot authorities have argued that there are specific exceptional circumstances, which have reversed the initial implementation of the 2007 restructuring plan and which impaired the long term viability of the company. In particular, the Cypriot authorities argued that:
 - a. The situation of the Greek and Cypriot economies, the main two markets of Cyprus Airways, had been significantly deteriorated since 2009 and 2010 respectively.⁸ According to the Cypriot authorities, the financial crisis in the two main markets of Cyprus Airways could not have been expected during the preparation of the 2007 restructuring plan.
 - b. The unstable political situation in the Middle East since 2010 forced Cyprus Airways to withdraw from certain traditional markets.
 - c. The effect of the ban imposed by Turkey on Cypriot aircrafts flying through its air space deprives Cyprus Airways of a level playing field with its competitors, particularly for routes serving the Russian market. According to the Cypriot authorities, the compensation granted by the State (see recital (17)) indeed reimburses additional flight costs, but Cyprus Airways is actually forgoing significant potential revenue due to the ban. This is because few passengers choose to use Cyprus Airways' service of Russian routes, due to the extended flight time.
 - d. The entrance of a new low-fare competitor, through the establishment of a new base in Cyprus, has created an uneven competitive field to the detriment of Cyprus Airways. This is because, according to the Cypriot authorities, a subsidy scheme has been set up for the initiation of new flights out of Cyprus (Larnaca and Paphos airports). Some of the new flights serve routes already served by Cyprus Airways. However, the latter cannot benefit from the subsidy scheme, since it is an established carrier

⁸ According to the Cypriot authorities, Cyprus Airways receives 31% of its revenue from the Cypriot market, whereas Greece is the second most important market for the company.

with a full utilisation of its fleet. Thus, the Cypriot authorities argue that Cyprus Airways has been losing market share in the contested flights.

- e. Cyprus Airways has been undercapitalised for a long time. According to the Cypriot authorities, the form and level of the 2007 restructuring aid was not appropriate for the operation of Cyprus Airways and did not cater for the exceptional circumstances arising later on.
- (36) Finally, the Cypriot authorities have argued that, because of the geographical location of the island, the seasonality of the market and the dependence of the Cypriot economy from financial services and tourism, the operation of Cyprus Airways is important for the infrastructure and development of the country. In conclusion, the Cypriot authorities have explained that a closure of operation of Cyprus Airways would be detrimental to competition, particularly in to/from Cyprus and in the Greek market.
- (37) As regards the *ex gratia* compensation, the Cypriot authorities maintain that it does not involve state aid. This is because, according to Cypriot legislation, personnel made redundant due to financial difficulties or limitation of operations, is entitled to compensation paid not by the employee but entirely by the RPF. Thus, any additional payment by the State on top of what the RPF is legally obliged to pay to redundant personnel would not confer an advantage to Cyprus Airways.

7. CONCERNS EXPRESSED BY COMPETITORS

- (38) After the initiation of the *ex officio* investigation in February 2012, several competitors of Cyprus Airways expressed serious concerns regarding the State participation in the company's planned capital increase. The competitors were mostly focusing on the fact that the planned State participation could involve state aid. This was because Cyprus Airways had received state aid for rescue and restructuring in the past, as well as state aid as a compensation for the Turkish overflight ban.

8. DEVELOPMENTS AFTER THE NOTIFICATION OF DECEMBER 2012

- (39) After the notification of a rescue aid loan of 13 December 2012, on 8 February 2013 a meeting was held between the Commissions services and the Cypriot authorities. The Cypriot authorities explained that the capital increase was by then concluded by a total of EUR 31.38 million, out of which the State had contributed EUR 31.3 million and other private investors had contributed EUR 89,000. That would increase the shareholding of the State to 93.3%.
- (40) During the same meeting, the Cypriot authorities confirmed that in addition to the EUR 31.3 million already contributed, an additional EUR 8 million from the loan was disbursed in January 2013.

9. ASSESSMENT

9.1. Difficulties of Cyprus Airways

- (41) The Commission recalls that point 10(a) of the Rescue and Restructuring Guidelines ('R&R Guidelines')⁹ establishes that a firm is regarded as being in difficulty 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

⁹ Communication from the Commission – Community guidelines on state aid for rescuing and restructuring firms in difficulty, OJ C 2044, 1.10.2004, p.2

been lost over the preceding 12 months. The Commission also notes that in accordance with point 11 of the R&R Guidelines, a firm may be considered to be in difficulty "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".

- (42) According to publicly available information, Cyprus Airways' key financial data since 2009 were as follows:

	2009	2010	2011	H1 2012
Turnover	247.5	236.3	212.8	71.3
EBT	-3.2	-2.9	-23.8	-34.2
Registered capital	35.2	35.2	35.2	35.2
Own equity	9.4	7.7	-15.9	-48.6

- (43) Point 10(a) of the R&R Guidelines establishes the presumption that a company that has lost significant part of its registered capital is not in a position to absorb losses that may lead it to insolvency in the medium to long term. The Commission considers that the same presumption applies *a fortiori* to a company that has lost its entire registered capital and has negative equity.¹⁰
- (44) With regards to point 11 of the R&R Guidelines, based on the information above, Cyprus Airways appears to have had diminishing turnover and increasing losses already since 2009, whereas it has had a negative own equity since 2011.
- (45) In view of the above, the Commission has reached the preliminary conclusion that Cyprus Airways was a firm in difficulty within the meaning of points 10 and 11 of the R&R Guidelines at least since 2010. The Commission equally considers that the company is in difficulties at present.
- (46) The Cypriot authorities also acknowledge that Cyprus Airways qualifies as a firm in difficulty since at least 2010.

9.2. Presence of state aid

- (47) 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.
- (48) 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 (i.e. transfer of State resources and imputability to the State, selective advantage, potential distortion of competition and affectation of intra-EU trade) are met for each of the measures identified.

9.2.1. State resources and imputability to the State in measure 1

- (49) The Commission notes that the first "in advance" payment to the planned capital increase was provided directly by the Cypriot State through the Ministry of

¹⁰ See Décision de la commission du 23.06.2010 concernant l'aide d'Etat no C 38/2007 mise à exécution par la France en faveur d'Arbel Fauvet Rail SA, para. 35.

Finance, as a function of the Additional Budget Law (Art.4) 50(11) of 2012. The Cypriot authorities were asked to confirm this disbursement by the State and have not contested the State origin. It is therefore clear that measure 1 entails State resources and that it is imputable to the State.

9.2.2. State resources and imputability to the State in measure 2

- (50) Measure 2 has been notified by the Cypriot authorities as state aid to Cyprus Airways.
- (51) Similarly to the first measure, the first tranche of the second measure (EUR 16.3 million) was granted by the Cypriot State through the Ministry of Finance, as a function of the Additional Budget Law (Art.4) 50(11) of 2012 and a Decision by the Council of Ministers of 4 December 2012. The remaining amount of the government loan will also be disbursed by the Ministry of Finance. Therefore, measure 2 entails State resources and is imputable to the State.

9.2.3. State resources and imputability to the State in measure 3

- (52) Any *ex gratia* payments will be paid by the State to the employees. Therefore, measure 3 entails State resources and is imputable to the State.

9.2.4. Selective advantage of measure 1

- (53) The Commission must assess whether measure 1 entailed a selective advantage to Cyprus Airways. In order to determine whether an economic advantage in favour of Cyprus Airways is present and therefore the measure in question involves state aid, the Commission must assess whether the undertaking received "an economic advantage, which it would not have obtained under normal market conditions"¹¹. To examine this question the Commission applies the market economy investor principle (MEIP). According to this test, where, in similar circumstances, a private investor operating in normal conditions of a market economy of a comparable size to that of the bodies operating in the public sector could have been prompted to make the capital contribution in question, no state aid would be involved. The Commission must therefore assess whether a private investor would have entered into the transaction in question on the same terms.¹² The attitude of the hypothetical private investor is that of a prudent investor¹³ whose goal of profit maximisation is tempered with caution about the level of risk acceptable for a given rate of return.¹⁴ If such a hypothetical private investor would not have carried out the transaction at the same terms, there is a strong indication that the MEIP test is not met.
- (54) The Commission notes that the first "in advance" payment for the planned capital increase in September 2012 was provided only by the State, as the majority shareholder, and that so far no other shareholder has contributed his share to the planned capital increase.
- (55) The mere expressed intention of only one other shareholder to contribute to the planned capital increase does not materially alter the fact that, until this point in time, the Cypriot State appears to be the only shareholder that has contributed "in advance" to the planned capital increase. In particular, at the time of the "in

¹¹ Joined cases T-228/99 and T-233/99, para.251.

¹² Judgment in Joined Cases T-228/99 and T-233/99 *Westdeutsche Landesbank GZ v Commission* [2003] ECR II-435 et seq, para.245.

¹³ Case C-482/99 *France v. Commission* [2002] ECR I-4397, para.71.

¹⁴ Joined cases T-228/99 and T-233/99, para.255.

advance" payment, no other shareholders or new investors appeared willing to contribute to a capital increase without a new business plan, which would guarantee the viability of the company and the turnaround needs and conditions. Contrary to the other shareholders, the State did not seem to take such considerations into account, choosing instead to invest in a company with negative equity and diminishing turnover, without any clear prospect about the future return of that investment.

- (56) Moreover, the State proceeded with the "in advance" payment without any type of security or guarantee. Indeed, the Commission notes that the first "in advance" payment appears to have been provided as a direct capital injection and not in any other form that would entail a security, such as shareholder loan. A shareholder loan would have put the Cypriot State in the position to ask for appropriate securities in order to ensure antecedent settlement of claims in the case of a possible bankruptcy of Cyprus Airways. The Commission believes that a prudent private investor or shareholder would have taken into account such a possibility to provide capital to a firm in need.
- (57) Furthermore, although at the time of the first "in advance" payment the turnaround plan had not yet been prepared (see (26) above), the Commission considers that the Cypriot authorities must have known that the capital needs of the company would be much higher than the originally planned EUR 45 million capital increase. This stems clearly from the financial statements of the company, and in particular its cash flow and negative equity in 2011.
- (58) Finally, it should be noted that for a capital injection to be considered as a decision in line with the MEIP, the Member State must provide evidence showing that the decision to realise the investment was taken, at the time, on the basis of economic evaluations comparable to those which, in similar circumstances, a rational private operator would have had carried out in order to determine its profitability.¹⁵ So far, the Cypriot authorities did not provide any such evidence.
- (59) Against this background, the Commission has doubts whether the first "in advance" payment was conducted on *pari passu* terms vis-à-vis other shareholders. In view of the significant difficulties of Cyprus Airways, the absence of viability prospects at the date of granting as well as given the alternative of a shareholder loan including appropriate securities, it seems reasonable to consider that a private investor would not have provided capital to that company under those conditions. The Commission comes to the preliminary conclusion that the conditions of the MEIP are not met and therefore the measure provided Cyprus Airways with an undue advantage. As the payment was granted for the sole benefit of Cyprus Airways, the advantage inferred from this measure would be selective in nature.

9.2.5. *Selective advantage of measure 2*

- (60) The Commission must also assess whether measure 2 entailed a selective advantage to Cyprus Airways. As in the case of measure 1, no other shareholder contributed to the planned capital increase, and there is no concrete information on any imminent contribution by a new investor. That is despite the fact that, between the disbursement of measure 1 (September 2012) and the disbursement of the first tranche of measure 2 (December 2012), the turnaround plan, which laid down the conditions, under which Cyprus Airways could return to viability, was made public.

¹⁵ Case C-124/10 P *Commission v EDF*, paras.82-84.

- (61) Furthermore, the turnaround plan on which measure 2 is based raises doubts as to whether it could be attractive to a market economy investor. Indeed, the turnaround plan proposes an expansion to the Greek market. However, following the recession in the past few years and projected for the following period,¹⁶ the Greek flight market, as a function of domestic demand and purchase power, is expected to contract as well. In addition, the Commission notes that, in order to implement the turnaround plan, an investment of EUR 105 million was required which is significantly above the aid amount of the capital increase in question.
- (62) In view of the significant difficulties of Cyprus Airways, the absence of viability prospects at the date of granting as well as given the alternative of a shareholder loan including appropriate securities, it seems reasonable to consider that a private investor would not have provided capital to that company under those conditions.
- (63) In that respect, the fact that the State was almost the only shareholder contributing to the planned capital increase, while other shareholders only contributed EUR 89,000 and preferred to be diluted, seems to be an additional indication that the measure conferred an undue advantage to Cyprus Airways.
- (64) Finally, the claim by the Cypriot authorities that the "in advance" payment of EUR 16.3 million is part of the rescue aid appears inconsistent with the original notification, which referred to a loan of EUR 73 million.
- (65) In any event, the Commission considers that the loan of EUR 73 million confers an advantage to Cyprus Airways. Indeed, no prudent creditor would provide a loan to of that interest rate (see recital (27) above) to a firm in difficulty, in particular since the Cypriot authorities have not demonstrated how Cyprus Airways will be able to repay the loan after six months.
- (66) As the payment was and will be granted for the sole benefit of Cyprus Airways, the advantage conferred from this measure would be selective in nature.

9.2.6. Selective advantage of measure 3

- (67) According to case law, the Commission, in order to assess the qualification of a measure as state aid, must examine not only the aims of the measure, but also its effect.¹⁷ At this stage, the Commission considers that the planned *ex gratia* payments by the State may confer a selective advantage to Cyprus Airways, in the sense that they may be alleviating the company from costs that it would have to incur otherwise.

9.2.7. Distortion of competition and effect on intra-EU trade of measures 1, 2 and 3

- (68) Since Cyprus Airways competes in the liberalised EU market for air transport with other EU airlines, therefore the measures identified above have the potential to distort competition and affect trade between Member States. Several competitors have already expressed their concern in this respect. The Commission notes that a small market share of the company is irrelevant for the assessment of the distortion of competition.

¹⁶ See The Second Economic Adjustment Programme for Greece First Review - December 2012 by Directorate General of Economic and Financial Affairs of the European Commission, p., available at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/pdf/ocp123_en.pdf

¹⁷ Case 173/73 *Italy v Commission* [1974] ECR 709, para.13.

- (69) The measures in question thus enable Cyprus Airways to continue operating because the company does not have to face the consequences normally deriving from its poor financial results.

9.2.8. Conclusions on the presence of state aid for measures 1, 2 and 3

- (70) On the basis of the reasoning set out above, the Commission considers at this stage that measures 1, 2 and 3 provided or may provide, if implemented according to schedule (for measure 2 and 3) a selective advantage to Cyprus Airways, stemming from State resources, which distorts or threatens to distort competition and affects trade between Member States. Under these conditions, the Commission considers at this stage that the measures identified above constitute state aid within the meaning of Article 107(1) TFEU. Measures 2 and 3 have in any event been notified to the Commission as a state aid measure.

9.3. Unlawful aid

- (71) The Commission notes that the measures 1 and 2 were implemented in breach of the stand-still obligation pursuant to Article 108(3) TFEU, as they have been disbursed already (September and December 2012). Thus, the Commission considers at this stage that the measures granted to Cyprus Airways qualify as unlawful state aid. Furthermore, from the information provided the Commission understands that the Cypriot authorities would not respect the stand-still obligation as regards the outstanding amounts. There is no information as to the granting date of measure 3. However, the decision of the Council of Ministers requests that the measure be compliant with state aid rules.

9.4. Compatibility with the internal market

- (72) 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.
- (73) 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.¹⁸

9.4.1. Measure 1: The first "in advance" payment of the capital increase

- (74) As regards measure 1, the Cypriot authorities have been asked by the Commission, but have not provided any comments as to whether it constitutes state aid and any possible grounds for compatibility of such aid.
- (75) The Commission has nonetheless assessed whether any of the possible compatibility grounds laid down in the TFEU would be applicable to the measure under assessment. The Commission considers at this stage that the exceptions laid down in Article 107(2) TFEU are clearly not applicable and have not been invoked by the Cypriot authorities. The same conclusion would apply to the exceptions foreseen in Article 107(3), points (d) and (e), TFEU.
- (76) The Commission has also assessed whether the measure could be compatible on the basis of Article 107(3)(b) TFEU. The Commission does not have any information, which would substantiate that aid in favour of Cyprus Airways could potentially "*remedy a serious disturbance in the economy*" of Cyprus, whereas the company's operations do not seem to fall under the definition of a project of common European interest. Finally, the crisis rules enshrined in the Temporary

¹⁸ C-364/90 *Italy v Commission* [1993] ECR I-2097, at para 20.

Framework applicable to the "real economy" expired in December 2011.¹⁹ The above is without prejudice to the financial situation in any Member State and relate, rather, to the potential effects of the measures.

- (77) Since Cyprus Airways is a firm in difficulty, the only legal basis for compatibility is the R&R Guidelines. Indeed, according to point 20 of the R&R Guidelines, "*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.*"
- (78) However, the Commission notes that the conditions for rescue and restructuring aid do not seem to be met. In particular, section 3.1 of the R&R Guidelines stipulates that "*In order to be approved by the Commission, rescue aid [...] must consist of liquidity support in the form of loan guarantees or loans*" and "*must come to an end within a period of not more than six months after the disbursement of the first instalment to the firm*". In addition, according to section 3.2 of the R&R Guidelines "*The grant of the aid must be conditional on implementation of the restructuring plan which must be endorsed by the Commission in all cases of individual aid.*" In addition, 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.
- (79) As regards the conditions under sections 3.1 and 3.2 of the R&R Guidelines, measure 1 does not appear to qualify neither as rescue nor as restructuring aid. Indeed, the measure is not a loan or a guarantee and was not terminated after six months. Moreover, no restructuring plan had been endorsed by the Commission at the time of the payment. The turnaround plan communicated to the Commission after the payment (see recital (26) above) does not *prima facie* seem to fulfil the conditions set out in section 3.2 of the R&R Guidelines, namely including measures for the avoidance of the undue distortion of competition or a significant real contribution to the restructuring plan by the aid beneficiary.
- (80) As regards the "one time, last time" principle of section 3.3, Cyprus Airways received rescue and restructuring aid during the period 2005-2007, which was then approved by the Commission decisions of 2005 and 2007 respectively (see recitals (13)-(15)). According to the "one time, last time" principle, Cyprus Airways is therefore in principle not eligible for such aid.
- (81) The R&R Guidelines (point 73) allow an exception of the "one time, last time" principle only: "
- 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*

¹⁹ Temporary Framework for state aid measures to support access to finance in the current financial and economic crisis, OJ C 16 of 22.1.2009, p. 1, as modified by the Communication from the Commission amending the Temporary Community Framework for state aid measures to support access to finance in the current financial and economic crisis, OJ C 303, 15.12.2009, p. 6. The Temporary Framework expired in December 2011.

- 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."*

- (82) At this stage the Commission cannot agree on the justification put forward by the Cypriot authorities (see (35) above) regarding the exceptions of point 73. The Commission considers at this stage that points 73(a) and 73(b) of the R&R Guidelines are not fulfilled in the case of the measures in question.
- (83) As regards point 73(c), the Commission notes the following:
- (84) The deterioration of the Cypriot and Greek economies, as well as the political unrest in the Middle East are uncontested events, and it may not have been possible to predict them accurately. However, at this stage, the Commission has doubts as to whether the effect of these events on Cyprus Airways is such, as to allow a derogation from the "one time, last time" principle.
- (85) A contraction or a recession are normal phases of the market economy and are part of the normal business risks that any undertaking has to bear. Indeed, based on the annual reports of Cyprus Airways at least since 2007, it seems that the company had acknowledged that *"the economic situation in Europe [...] may adversely affect the travel industry and consequently the Group's and the Company's results"*.²⁰ Thus, the evidence suggests that it had been clear to the company's management that economic difficulties in certain countries could have an impact on the Cypriot economy in general and the business of Cyprus Airways in particular. A prudent undertaking, having acknowledged such risk, would have taken countermeasures.
- (86) The Cypriot authorities have not explained what relevant measures Cyprus Airways undertook. On the contrary, the company appears to have taken the strategic decision to expand its operations in the Greek market, having increased its flights in Greek domestic routes since 2011.
- (87) Against this background, the Commission considers that the Cypriot authorities have not substantiated to what extent the deterioration of the Cypriot and Greek economies is the cause for the company's difficulties since 2010 and should qualify as exceptional and unforeseeable circumstances, within the meaning of the R&R Guidelines.
- (88) As regards the political unrest in the Middle East, the Commission notes that the Cypriot authorities failed to substantiate why these event are exceptional and unforeseeable to Cyprus Airways and to what extent these events caused the company's difficulties since 2010. Indeed, the company's annual reports indicated at least since 2007 that *"[...] the political upheavals in the Middle East may adversely affect the travel industry and consequently the Group's and the Company's results..."*²¹ In addition, the Commission observes that, based on the company's annual reports, the revenue from routes to the Middle East and the Gulf region appears to have been historically approximately 10% of the total revenues of the company. In this context, the Commission doubts whether the impact of the

²⁰ See 2007 Annual Report, p.97; 2008 Annual Report, p.88; 2009 Annual Report, p.91.

²¹ Ibid.

political unrest in the Middle East is significant enough in order to justify an exception to the "one time, last time" principle.

- (89) The ban imposed by Turkey on Cypriot aircrafts flying through its air space appears to have been in place since 1974.²² It can therefore not qualify as an unforeseeable circumstance. In any event, the Commission emphasizes that it has approved a compensation scheme for the additional costs incurred by any affected carriers (see (16)-(17) above). Cyprus Airways, which benefits from the scheme, is in principle to be considered as compensated for that situation.
- (90) Similar to (87) above, the Commission has doubts as to whether the entry of a new competitor can be considered an exceptional and unforeseen circumstance, since this may happen to any operator in any liberalised market. What is more, the Commission underlines that as the subsidy scheme for new flights is set up by the Cypriot authorities, it cannot be argued that the State is providing state aid to Cyprus Airways in order to offset the harmful effects of a measure that the State itself has established, and qualify the latter as exceptional and unforeseen circumstance.
- (91) Finally, the fact that Cyprus Airways is deemed undercapitalised is a result of the difficulties, which the company has faced since 2010 and cannot as such be considered as an exceptional and unforeseeable circumstance.
- (92) The Commission notes that the concerns of the Cypriot authorities about the impact of the closure of Cyprus Airways on the national economy as described in recital (36) above, as well other general considerations such as the lack of connectivity due to Cyprus' geographical location, are in principle not apt, on their own, to justify a derogation from the 'one time, last time' principle.

9.4.2. Measure 2: The rescue aid

- (93) As regards measure 2, the Cypriot authorities have notified the measure as compatible rescue aid under the R&R Guidelines. However, similar to measure 1, the Commission notes that the conditions for rescue aid do not seem to be met.
- (94) In particular, point 25(a) of the R&R Guidelines stipulates that "*In order to be approved by the Commission, rescue aid [...] must consist of liquidity support in the form of loan guarantees or loans*". According to the Cypriot authorities, the EUR 16.3 million provided to Cyprus authorities has so far taken the form of capital injection in the context of a capital increase. This is therefore not a loan or a guarantee.
- (95) In addition, following the reasoning of recitals (81)-(96) above, the conditions of endorsement and implementation of a restructuring plan and the "one time, last time" are not met for measure 2 either.
- (96) Although not invoked by the Cypriot authorities, the Commission has nonetheless assessed whether any of the possible other compatibility grounds laid down in the TFEU would *prima facie* be applicable to the measures under assessment. The assessment of the recitals (78)-(80) above applies also to measure 2.

9.4.3. Measure 3: Ex gratia compensation

- (97) If implemented, measure 3 could have the effect of alleviating Cyprus Airways from costs that it would have to incur in the context of its restructuring. It would therefore have to be considered as rescue or restructuring aid under the R&R Guidelines.

²² See SA.32523 (2011/N), Decision of 27 June 2012, published in OJ C 230, 1.8.2012, para.11.

(98) Similar to the reasoning set out in recitals (77)-(100) above, the Commission notes that the conditions for rescue or restructuring aid do not seem to be met. At this stage, and taking into account the fact that Cyprus Airways is a firm in difficulty, it seems that no other compatibility grounds apply to measure 3.

9.5. Conclusion on compatibility

(99) In view of the above, the Commission has doubts on the compatibility of measures 1, 2 and 3 with the internal market.

10. DECISION

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.

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 of the Commission